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NIC 02848-88
9 August 1988

MEMORANDUM FOR THE RECORD

SUBJECT: August 9 Meeting of the Economic Policy Council
a. Limits on Meat Imports
b. Negotiations with the European Common Market
c. U.S.-Japan Free Trade Initiative
d. Drought Relief

1. ~~This was Secretary Baker's last EPC meeting -- the 147th meeting since he began the group in 1985.~~

2. ~~The Council agreed to ask Australia and New Zealand voluntarily~~ to ~~limit beef exports to the United States.~~ Voluntary limits would prevent the United States from initiating formal quotas to keep beef imports under the limits established in the Meat Import Act of 1979. Only CEA objected, wanting to wait until September to get a better idea of beef import levels.

3. At the urging of Deputy Secretary Whitehead, the EPC decided not to end discussions on Japan-U.S. free trade, in unspoken deference to Ambassador Mansfield who is the sole advocate of the plan.

4. Secretary Baker urged that a delegation of cabinet members travel to the European Community to impress on them the seriousness the United States attaches to prior consultations on legislation relating to Europe "1992". Baker said that, at a minimum, we should elevate the issue and force the Europeans to say "no" loudly. (This is a major issue for Community collection, and I will hold meetings to see how we can help USTR on this matter.)

5. Secretary Lyng reported on the drought and the $3.9 billion farm relief bill. Lyng said no matter what August brought, there was a very severe water problem west of the Rockies that only could be solved by unusually heavy snows. The Council spent some time discussing issues in the relief bill relating to the November election.

6. Lastly, Ambassador Yeutter said U.S. rice growers would file a 301 petition against Japan on September 15. The final date for a decision on whether to pursue the case would be two days before the general election. The United States has promised Japan it would not take action on rice as part of the agreement to get Japan to end quotas on beef.

Deane E. Hoffmann

Deane E. Hoffmann

cc: EA/DCI
D/EURA
D/OEA
D/OGI
NIO/EA
NIO/EUR

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EXECUTIVE SECRETARIAT

ROUTING SLIP

TO:

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Remarks

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Executive Secretary

8 Aug '88

Date

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THE WHITE HOUSE
WASHINGTON

Executive Registry
88-2914X

CABINET AFFAIRS STAFFING MEMORANDUM

Date: 08/05/88 **Number:** 490,772 **Due By:** -----

Subject: Economic Policy Council Meeting -- Tuesday, August 9, 1988 11:00 a.m. -- Roosevelt Room

	Action	FYI
ALL CABINET MEMBERS	☐	☐
Vice President	☑	☐
State	☑	☐
Treasury	☑	☐
Defense	☑	☐
Justice	☑	☐
Interior	☐	☐
Agriculture	☑	☐
Commerce	☑	☐
Labor	☑	☐
HHS	☐	☐
HUD	☐	☐
Transportation	☑	☐
Energy	☑	☐
Education	☐	☐
Chief of Staff	☑	☐
OMB	☑	☐
UN	☐	☐
USTR	☑	☐
CEA	☑	☐
CIA	☑	☐
EPA	☐	☐
GSA	☐	☐
NASA	☐	☐
OPM	☐	☐
SBA	☐	☐
VA	☐	☐

	Action	FYI
CEQ	☐	☐
OSTP	☐	☐
Powell	☑	☐
Cribb	☑	☐
Bauer	☑	☐
Dawson *(For WH Staffing)*	☑	☐
Executive Secretary for:		
DPC	☐	☑
EPC	☑	☐

REMARKS:

The Economic Policy Council will meet on Tuesday, August 9, 1988, at 11:00 a.m. in the Roosevelt Room. Attached are the background materials for your review.

RETURN TO:

☑ Nancy J. Risque
Cabinet Secretary
456-2823
(Ground Floor, West Wing)

☐ Associate Director
Office of Cabinet Affairs
456-2800
(Room 235, OEOB)

DCI EXEC REG

R-504-1R

THE WHITE HOUSE

WASHINGTON

August 5, 1988

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: WILLIAM J. MARONI

SUBJECT: Agenda and Paper for the August 9 Meeting

The Economic Policy Council will meet on Tuesday, August 9, 1988 at 11:00 a.m. in the Roosevelt Room. The agenda and papers for the meeting are attached.

The Council will discuss four agenda items:

1) U.S. Meat Import Act estimates and proposed action

The Council will consider the Agriculture Department's proposal to limit meat imports as a result of the most recent quarterly import estimates, as required by the Meat Import Act of 1979. A paper by the Trade Policy Review Group is attached.

2) U.S. approach to the European Community's Internal Market exercise

The Council will be asked to review a paper by the Trade Policy Review Group describing the EC Internal Market exercise and to consider recommendations for Administration response.

3) Policy Statement on proposed U.S.-Japan Free Trade Agreement

The Council will discuss a draft policy statement concerning current studies on the feasibility and desirability of a proposed U.S.-Japan Free Trade Agreement. If approved by the Council, the statement will constitute the Administration's official response to inquiries on the U.S. Government's position.

4) Report from the Drought Policy Committee

Agriculture Secretary Lyng will brief the Council on the work of the Drought Policy Committee, plans to implement the emergency drought legislation, and outlook for economic and trade effects of the drought. A report by the Drought Policy Committee is attached.

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ECONOMIC POLICY COUNCIL

August 9, 1988

11:00 a.m.

AGENDA

1. U.S. Meat Import Act of 1979 estimates and proposed Administration reaction
(Secretary Lyng and Ambassador Yeutter)

2. U.S. approach to the European Community's Internal Market exercise
(Ambassador Yeutter)

3. Policy Statement concerning proposals for a U.S.-Japan Free Trade Agreement
(Ambassador Yeutter)

4. Report by the Drought Policy Committee
(Secretary Lyng)

THE UNITED STATES TRADE REPRESENTATIVE
Executive Office of the President
Washington, D.C. 20506

August 4, 1988

MEMORANDUM

TO: The Economic Policy Council

FROM: Ambassador Clayton K. Yeutter

SUBJECT: TPRG-Approved Policy Guidance on the European Community "Internal Market" Program

The Trade Policy Review Group (TPRG), meeting on August 3, approved the attached policy paper concerning the European Community's "Internal Market" program. The TPRG's approval of this document provides the Administration with a number of approved policy guidelines in respect of what is unquestionably a major development in the international economic arena. I would hope that we could agree to endorse the TPRG's action on this matter.

Attachment

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TRADE POLICY REVIEW GROUP

THE EUROPEAN COMMUNITY "INTERNAL MARKET" EXERCISE: AN INITIAL ASSESSMENT AND RECOMMENDATIONS

ISSUE

The European Community (EC) has for some time been embarked on an ambitious program aimed at "completing the internal market" by 1992. Many of the known details of the internal market program are addressed in appendix B to this paper. In essence, the single market is a legislative program comprising nearly 300 EC directives and an array of related endeavors the objective of which -- taken in toto -- is the removal of (a) internal frontier controls (and consequently the frontier posts themselves), and (b) barriers which restrict entry into an EC member country's businesses. The full or substantial realization of the program will profoundly affect the European economic and political landscape, the way American-owned firms do business with and within the EC, and the bilateral trade and investment relationship. The program marks progress toward the economic integration of Europe, support for which has been a basic tenet of U.S. foreign policy since World War II. The Community's goal in undertaking the single market is to increase the efficiency of the European economy, and to increase the competitiveness of Europe by allowing freer rein to market forces. However, there are elements to the program which offer legitimate reasons for concern. While the U.S. Government and the American business community have an imperfect understanding of all of the implications of the program at this stage (in part, because it is evolving), it is nevertheless possible to come to an initial assessment which calls for a number of policy recommendations.

RECOMMENDATIONS (Not in Priority Order)

1. The USG should continue to aggressively pursue EC agreement to a more constructive dialogue on issues relating to the internal market program. Where appropriate, comments should be developed on individual implementing directives in anticipation of talks with the EC. To be fully effective, the dialogue should provide for technical-oriented comment and exchange of information on both directives which have already been proposed to the Council and Parliament and those still in the planning phase. As a second element to the dialogue, the USG should pursue a higher level discussion of generic policy concerns, such as those relating to reciprocity, national treatment and evolving EC external trade policies.

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2. The USG should systematize its use of lobbying efforts with member states as we seek to amend existing legislation or change/block proposed directives. Our embassies should be kept informed of developing USG attitudes on individual directives to insure a constructive dialogue. In addition, the USG, and in particular, the U.S. Mission to the EC (USEC), should expand economic policy contacts with the European Parliament in light of the Parliament's enhanced role in the legislative process leading to EC directives' approval. Protection of U.S. economic interests is more likely to require subtle, yet active, lobbying efforts with key Parliamentary committees. USEC should be asked to prepare a guide to the organization of Parliament and profiles of key potentially helpful European Parliament members and staff.

3. The USG should begin consideration of whether -- in the context of the internal market program -- American economic interests in the EC are adequately protected by the existing collection of (a) bilateral FCN treaties with the individual member states; (b) multilateral commitments in the OECD and the GATT; and, (c) multilateral negotiating initiatives in the Uruguay Round. A further review should be conducted of existing economic agreements (bilateral and multilateral) to determine our rights and whether additional agreements or alternative means of protecting our interests are needed.

4. The USG should exchange information through informal, low profile, consultations with those other countries and groups of countries that are actively considering the implications of the internal market program. In the autumn of 1988, the USG should consult on key issues with the EFTA countries. As individual cases warrant, or circumstances permit, the USG might also consult with other interested third countries.

5. The TPSC Task Force should undertake an analysis of the implications of the single market exercise for EC positions likely to be taken in the Uruguay Round. In addition, the impact of the program on key industrial and service sectors should be analyzed. Where appropriate, these analyses should be used in support of further policy recommendations to the TPRG.

6. The USG should actively work with groups such as the Chamber of Commerce (both the U.S. Chamber and the AmCham "EC Committee" in Brussels), the Business Roundtable Task Force, the private sector advisory committee network and others to insure an effective exchange of information and that U.S. business and other interest groups have sufficient early awareness and information on developments in the internal market program.

7. Because we can be more effective when policy-makers speak with one voice, USG officials at all levels should be encouraged to adopt a "common line" on the single market in their public comments, in discussions with newspaper reporters or business persons, and in letters to Community officials. Appendix A contains the elements to be reflected in this common line.

8. Current USG concerns relate almost exclusively to potential problems with the Community which would arise in the event certain policy measures under discussion are fully adopted by the Community. With respect to specific areas of concern identified in conjunction with the internal market program:

-- The USG should take a strong stand against any reciprocity provisions whose aim is sector-specific equivalence. Sectoral reciprocity should be strongly resisted.

-- We should take a strong stand against any policies which discriminate among European firms by parentage, location of headquarters or management or between European and non-European firms (except as permitted under our FCNs and OECD codes).

-- In addition to reciprocity, the disposition of other investment issues will be critical to U.S. interests. Chief among these will be right of establishment, mergers and acquisitions policy, and decisions on local content requirements for manufacturers. The USG needs to work for non-restrictive, non-discriminatory decisions on these and related issues.

-- The USG should take the position that, under no circumstances, does the completion of the internal market justify the translation of existing GATT-illegal member state trade barriers into Community-wide trade measures (even on a transitional basis) administered out of Brussels. The EC should be advised that any such erection of new external trade barriers would draw a rapid response from the United States.

-- As it proceeds with new directives designed to harmonize internal technical regulations in veterinary, phytosanitary and other similar areas, the Commission should be urged to provide for recognition of measures in the United States and elsewhere with equivalent effect (as opposed to identical application) in order to avoid repetition of the unfortunate experience with the hormones directive and the third-country meat directive (both "internal market" initiatives).

-- As it proceeds with new directives designed to harmonize standards on industrial, and primary and processed food products, the Commission should be urged to provide for the participation by interested U.S. parties in the standards development process and for arrangements on the mutual acceptance of test data.

-- Where internal market initiatives parallel subjects under discussion in the Uruguay Round, the USG should urge the Commission to take advantage of progress in the multilateral negotiations as a force to help drive the internal market process, rather than postponing multilateral initiatives until an internal regime is in place.

BACKGROUND

1. General

Appendix B provides a general political/economic overview of the EC's internal market completion program together with an assessment of how these initiatives will impact the Community on a member state-by-member state basis. As noted above, the internal market program is effectively a legislative program consisting of some 286 directives designed to bring about a single EC market through the removal of widely diverse reasons for frontier checks and the suppression of barriers which restrict entry into a member country's businesses. Examples of the former include divergent VAT rates and differing measures to control foot and mouth disease. Examples of the latter include rules on the establishment and operation of businesses in the mortgage credit field and access to heretofore excluded sectors of public procurement.

2. <u>Transparency Issues: How we communicate with the EC</u>

An important problem which has arisen with respect to the internal market completion program relates to the fact that the drafters of the implementing directives are, in general, unwilling to discuss their initiatives with the U.S. Government while these are in the drafting (i.e., pre-publication) stage. The Commission maintains that the system whereby proposed directives are published in the Official Journal at the time of transmission to the Council and the Parliament provides us with sufficient transparency and opportunity to comment (Lord Cockfield has been known to argue that, on average, it takes two years for a directive to be approved through the so-called "cooperation procedure"). Our experience, however, is that once a directive has been published in the Official Journal, the Commission -- having completed much of the necessary internal "horse trading" with member state and industry representatives is not willing to reopen the directive to accomodate changes which reflect third-country interests. Directives are frequently changed to reflect Parliament and member state views, and the USG will have to be vigilant to developments in order to mount a timely lobbying effort with these groups on directives. Concrete examples of where this has been a problem are the hormones and third-country meat directives and (outside the immediate internal market context) certain telecom initiatives.

We have been trying, to date with limited success, to reach agreement with Vice President Cockfield and members of his cabinet on the establishment of a constructive dialogue to address issues and perceived problems arising out of internal market related initiatives. Following Secretary Verity's May 25 meeting with Lord Cockfield, it was thought that we had obtained a commitment to such a dialogue, on a one-time basis, but when we sought to give practical application to this commitment with proposed meetings in mid-July, the EC balked. We are continuing to pursue this initiative for discussions, both at the technical level and also at a higher level (to take up the important generic trade and investment policy issues referred to below).

The USG needs to recognize the different abilities our investors have to influence the EC as opposed to our exporters. U.S. companies with subsidiaries in Europe have much greater access to the Commission and to draft directives through advisory bodies and trade associations, whose expertise is frequently solicited as directives are crafted. U.S. exporters, on the other hand, will require greater assistance from the USG to ensure that directives are not promulgated which harm their interests in the EC market.

3. <u>Presenting USG views to the European Parliament and Member States</u>

With the movement of the majority of the internal market directives from the Commission to active consideration in the Council and the Parliament, we need to improve our communications with both the member states and the Parliament. As proposed above, we should systematize our lobbying efforts with the member states through our embassies (the route to the Council) and reconsider our position vis a vis the Parliament.

The European Parliament still lacks authority comparable to the U.S. Congress in the legislative process, but with the entry into force of the Single European Act and the so-called "cooperation procedure" for directives related to the internal market, the influence of the Parliament has been greatly increased. In considering proposed directives from the Commission, the Parliament has the ability to propose amendments (and has shown that it is willing to do so). Although the Parliament can, under Community rules, be overridden by the Council and the Commission, these latter groups are reluctant to ride roughshod over the only directly-elected institution of the Community.

This brings us to the consideration of how the Parliament's role in the process can be used by the USG in arguing for changes in those internal market directives which we find objectionable. Certain representatives of U.S. business active in Brussels have suggested that they have been able to take advantage of the process in the Parliament to effect changes to proposed directives.

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with the Commission's reluctance to entertain our comments and proposals in this area, it may well be necessary for the USG (through USEC) to focus greater attention on the activities of relevant Parliamentary Committees. Attempts to influence the process would necessarily need to be subtle and would require us to first identify Parliamentary interests paralleling our own. Ambassador Kingon has placed increasing priority on the dialogue with the Parliament, but more targeted lobbying on specific economic policy questions may be helpful.

4. <u>Reviewing the Rights and Protections of Existing Instruments</u>

In examining the degree to which U.S. economic interests are currently protected by the existing collection of bilateral FCN treaties with individual member states, together with OECD/GATT commitments on national treatment, questions of adequacy have arisen in respect of the EC's proposals (at present in the banking and securities fields) for reciprocity tests. Most of the FCN's, for example, contain exceptions to national treatment obligations in the banking sector.

Banking is covered by the OECD Codes of Liberalization and the National Treatment Instrument. The Codes provide for progressive liberalization of capital movements and contain non-discrimination (i.e., Most Favored Nation) provisions. However, they also contain a provision permitting members of a customs or monetary union to take additional liberalizing steps among themselves before generalizing the benefits to all OECD countries. The Code for Liberalization of Capital Movements contains in addition a right of establishment for inward direct investment. This provision provides that foreign investors be accorded the same treatment as local investors (i.e., national treatment) on entry. Furthermore, the National Treatment Instrument provides foreign investors with national treatment after entry. Under the Codes and the Instrument, countries have listed "reservations" and "exceptions" to grandfather their existing non-conforming practices. Countries are expected to remove progressively these reservations, the justifications for which are examined periodically by the Organization.

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The EC's ability to discriminate against U.S. economic interests in Europe is nevertheless constrained by two other factors. First, many of the national FCN's have MFN obligations, despite the lack of national treatment. Second, U.S. subsidiaries legally established in the EC are protected against discrimination by virtue of Article 58 of the Treaty of Rome.

If it is discovered that these areas are not sufficiently protected by either bilateral or multilateral agreements, then the USG should evaluate whether alternative means of protecting U.S. interests are in order or whether new, bilateral, negotiations with the EC are in order as a means of protecting U.S. investors against potential discrimination in certain sectors.

5. Informational consultations with third countries

The vast scope and complexity of the internal market exercise make it difficult for any group (in the government or outside) to develop an adequate appreciation of where its interests are genuinely likely to be impacted by the EC's initiatives. The USG is not alone in its study of the internal market -- other countries and groups, most notably in the EFTA group, have well-advanced task forces on the internal market's implications. Very informal discussions with representatives of the Norwegian and Swiss governments have shown that they would welcome the opportunity to compare notes with the USG on our perceptions of the EC activities. In order to increase our own understanding of the issues, we believe it would be useful to initiate informal low-profile consultations with some or all of the countries identified above. Additionally, third countries can provide useful help in lobbying the EC on specific directives, as occurred on the Fats and Oils Tax issue. These consultations might be held in the autumn.

6. Uruguay Round Policy and Sectoral Analysis

The Task Force has only just begun to analyze the impact of the internal market exercise on the Uruguay Round positions to be taken by the EC; however, it is clear that the single market program will not affect all Uruguay Round initiatives in the same way. Further, and more in-depth, analysis is called for in this area, with recommendations, as appropriate being made to the TPRG. The same holds for a number of key sectors where the impact of the internal market program will be very different from one sector to the other. Work along these lines in the Task Force should continue.

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7. Working with the private sector

The EC Committee of the American Chamber of Commerce in Brussels is far ahead of most other groups in its appreciation of the impact of the internal market initiatives and business strategies for dealing with the coming changes. That Committee, however, is composed of "European companies of American parentage" whose interests (as invested subsidiaries) might not always concord with U.S. exporters. The Business Roundtable has also established an internal market task force and in mid-July, the American Chamber of Commerce got in the act with the creation of a new committee to look exclusively at the implications for U.S. business of the internal market.

The USG should actively cultivate institutional links with these business groups and other private sector groups, in order to ensure a productive exchange of information and, more importantly, to ensure that private sector input is rapidly directed to policy-makers.

8. A "Common line" on the Internal Market

Because we are most effective as a government when we speak with one voice and because we do not wish to give the Community conflicting signals (particularly where sensitive issues may be involved), it is desirable for U.S. Government officials at all levels to ensure that the positions they take in respect of the internal market reflect major elements of a common policy line. The elements of a common policy line are found in appendix A. It is suggested that these points be generally reflected in comments to the press, letters to EC officials, contacts with businessmen, etc. Clearly, there will be instances where it may not be appropriate to refer to all of these elements; however, an effort should be made to reflect the balance of U.S. interests involved in the internal market program.

9. Some critical issues

External aspects of the single market program have not been fully determined. The EC is currently developing a paper to prepare for policy decisions on many of the issues of critical importance to the USG.

(a) Reciprocity and National Treatment:

EC directives addressed to banking, insurance, and securities trading are all notable for their inclusion of reciprocity tests designed to condition access of third-country firms to the liberalized EC financial markets. Debate continues within the Community on the direction to give to the reciprocity provisions in these directives, and the final outcome of that discussion is not clear. On their face, these provisions (such as the Second Banking Directive's Article 7) appear to require third countries to provide for access and business conditions for EC-based financial institutions equivalent to those which will prevail in the Community. With the introduction in the Community of a single license system and home country supervision (for banking), a restrictive application to the United States of a reciprocity test could well lead to discrimination against U.S. firms' activities in the EC. USG policy in the financial sector is national treatment, defined as "equality of competitive opportunity". This policy is embodied in the International Banking Act of 1978. The implementation of the policy in the EC which is contrary to this concept of national treatment would be a matter of great concern to us. We need to examine our rights under the FCNs and the OECD Codes.

(b) Retroactive Reciprocity-inspired Restrictions:

It has generally been assumed that even were the restrictions referred to above to enter into force, they could be applied only to firms seeking access to the Community after the relevant directives' entry into force. Speaking in London on July 12, Willy De Clercq suggested (for the first time) that reciprocity-inspired restrictions under the Second banking directive might also be applied to non-EC-owned banks already established in an EC member country. The retroactive application of such measures would substantially add to our concerns in respect of EC reciprocity provisions and may constitute violations of Article 58 of the Treaty of Rome and provisions in a number of our FCN treaties with individual member states, as well as relevant OECD instruments.

(c) Investment Policy Issues:

Since direct investment is one of the chief routes of access by American companies to the EC market, EC investment policy is critical to U.S. interests.

Investment concerns cut across many sector-specific issues and implications for investment fall out of many apparently-unrelated directives. (The foremost example is provision for reciprocity tests in the banking, insurance and securities directives). This makes adequate surveillance of EC investment policy and especially difficult task, and makes continuing and effective interagency coordination essential.

Given the extent of our knowledge to date, development of EC investment policy has been uneven. Reciprocity tests, if enacted, would be anathema. On the other hand, early proposals on mergers and acquisitions suggest that a fairly liberal policy is in the works. Other areas to watch include right of establishment, commercial policy, and local content requirements and other trade-related investment measures.

We are sensitive to the fact that the EC (and particularly De Clercq) seems fully prepared to use investment policy as a lever to gain concessions from third countries in return for access to an integrated EC market. Reciprocity may be only the first step in that direction. Investment is vulnerable to this tactic because accepted, normative foreign direct investment practices are not as comprehensively covered by bilateral and multilateral agreements as are trade practices.

(d) GATT-illegal member state QR's:

The question of "residual" quantitative restrictions (QRs) maintained by individual member states is a matter of some concern. If the Commission realizes its goal of eliminating border controls between member states in the internal market program, then it will become physically impossible for member state authorities to continue to enforce most of these selective trade barriers. Ideally, this situation should lead to the elimination of these restrictions and consequent liberalization of portions of the Community trade regime. However, Commission spokesmen (De Clercq and others) have suggested that continued protection will be required in certain "sensitive" sectors and have suggested that some of the existing member state QRs (for example, in autos) may need to be translated into Community-wide protective measures.

For example, there are reports that the Commission is close to presenting a proposal on the automotive sector (the frequently used example of residual QR's). The Commission would eliminate subsidies in the sector (as it has recently attempted in the Rover and Renault cases), harmonize type certification, and establish a Community-wide restraint, seemingly a VRA (to be eventually phased-out) on Japanese imports at roughly current levels of penetration.

The USG has already notified the Community's residual QRs as GATT-illegal measures subject to the Uruguay Round rollback exercise. Any attempt by the Community to erect new barriers to trade through the broadening of such member state QRs to a Community-wide basis should be met with a forceful negative reaction by the United States. This should be the case not only for those product sectors where our own exports to the EC would be affected but also in other product areas where new EC barriers would intensify trade diversionary effects.

(e) The "Equivalency" Issue:

Purportedly, the EC's "Hormone Directive" is intended to harmonize member state procedures on ensuring that meat for human consumption has no hormone residues by banning the use of such growth hormones in livestock production within the EC. In the U.S., the use of a number of growth hormones is approved and meat does not contain unacceptable residue levels. In order to continue our exports of meat and meat products to the EC after the entry into force of the directive, the USG sought EC acceptance of our guarantee that U.S. meat shipped to the EC would not contain harmful residues of hormones. The EC has rejected this equivalence guarantee and demanded that U.S. meat must come from untreated animals -- a condition which it is not possible to certify. A similar experience was occasioned by the

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third-country meat directive where trade frictions were avoided in the end only through U.S. industry's compliance with the conditions of the EC directive. Both of the above directives are part of the program laid out in the Commission's 1985 white paper on the internal market and, to the extent that the Commission does not provide for equivalence guarantees in future similar directives, we may have more problems of this genre. We should lobby the EC, including member states, to ensure that the equivalence concept is built into future standards directives.

(f) Standards on Industrial Goods and Primary/Processed Foods:

Under the "New Approach", the EC Commission will define "essential requirements" which are primarily health and safety requirements, for specific products or industries. Once essential requirements have been met, or in products where essential requirements are not drafted, member states must recognize the adequacy of each others' standards and allow free movement of goods and services on that basis. The EC Commission is also proposing a system of mutual recognition of test data and certification procedures for products destined to circulate within the EC.

The EC approach to standardization may have a significant negative impact on U.S. exports, because harmonized standards may be framed in a way that would restrict the market access of U.S. products. U.S. companies in the pharmaceutical, machinery, and food processing industries, for example, have already expressed concern that proposed EC standards would not be compatible with U.S. industry standards and therefore would hinder their ability to sell to the European market. At present, U.S. exporters are not allowed to participate in EC standards-drafting committees, and do not have the ability to review and comment on draft EC standards at an early stage. Moreover, the EC so far has been unwilling to accept U.S.-generated test data or certifications for purposes of mutual recognition.

(g) Uruguay Round Effects of the Internal Market:

A number of subject areas under negotiation in the Uruguay Round are also the subject of parallel initiatives in the internal market exercise. Expanded government procurement coverage, testing and inspection, intellectual property rights, investment,

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and services all fall into this basket. In some cases, (coverage within the EC procurement directives of the heretofore "excluded sectors"), the Community's initiatives are having a positive, reinforcing effect on positions taken by the Community in Geneva. In others, (such as the testing and inspection initiative in the standards area) the Community is taking the position that internal liberalization must be completed prior to multilateral negotiations--negatively impacting the Uruguay Round pace. For the moment, the EC approach to intellectual property questions appears supportive of our common efforts in the Uruguay Round. In the services and investment fields, however, it is still too early to tell whether the internal market exercise will reinforce or hinder the progress of the Uruguay Round.

APPENDICES

A Proposed Common "Party Line" on the Single Market

B Political/Economic Overview of the Single Market

A

APPENDIX A

ELEMENTS OF A COMMON LINE* ON THE SINGLE MARKET

-- Recognize longstanding USG support, in principle, for European economic integration as a tenet of policy.

-- Note that businesses look forward to new opportunities and the ability to rationalize efforts in a single market of 320 million.

-- Recognize the expected positive contribution of EC single market efforts to multilateral liberalization (cite examples of public procurement and intellectual property protection).

-- Take note of EC assurances that the internal market will not lead to "Fortress Europe" and indicate we hope this will be the case.

-- State clearly that U.S. interests will be vigorously defended where threatened by single market initiatives.

-- Stress that EC should not expect U.S. to "pay a bill" for the single market: increased restrictions on third parties' trade or investment are not acceptable, nor is the notion that the EC is owed a credit for liberalization undertaken for the EC's own reasons.

-- Indicate strong U.S. opposition to reciprocity provisions.

-- Express concern over reported Commission plans for EC-wide trade barriers in place of existing residual QR's.

-- Recall that EC inflexibility on acceptance of measures with equivalent effect has created past problems and express hope this will not be the case in the future.

-- State expectation that EC harmonization of industrial standards will take account of U.S. industry interests.

-- Express expectation that existing bilateral and international commitments will be fully respected and will not be impaired.

-- Stress the need for a timely and successful conclusion to the Uruguay Round of trade negotiations.

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* Uses of the "common line":

- -- public statements by USG officials;
- -- letters written to Comunity officials; and,
- -- oral comments to newspaper reporters and businessmen

THE POLITICAL AND ECONOMIC SETTING FOR EUROPE'S PUSH TOWARDS MARKET INTEGRATION

Full European economic integration, leading to the complete removal of internal frontiers and border posts, has been a goal of the European Communities since 1957 and the Treaty of Rome. However, after early initial success for the EC -- a common commercial policy which gave Europe a single voice on trade, the common agricultural policy (CAP) and, later, a common fisheries policy -- the pace slowed, largely because member states were unwilling to yield further sovereignty.

Now, in an environment of increased economic interdependence, European leaders are opting for further unification. As a result, the twelve member states of the EC are hard at work harmonizing the rules of their markets, in goods, services, capital and labor. European leaders and business hope the effort to create a single economic space, in which goods, services, capital and people can move freely, will help them to escape the late-70's economic slowdown ("Eurosclerosis"), to compete on a global scale with Japan and the U.S., and to maintain Europe's economic and political role in the world.

The U.S. has consistently supported the goal of Western European integration since a strong Europe serves our economic, political and security interests. In a recent speech the President declared, "Today, when the economic strength of Western Europe and the United States are fully comparable, the time has long since come when we will view ourselves as equal partners. And a more equal relationship should not diminish our bonds, but strengthen them. It should not limit our potential, but expand it." A vibrant Europe reinforces the common bond of democracy, strengthens the Atlantic Alliance, eases the budget pressure on the U.S., and is a powerful engine for global economic growth.

TIMING IMPROVES CHANCES OF SUCCESS

The present push for integration is driven by a confluence of forces that have not been present in earlier efforts. First, the impetus comes not only from EC politicians, but also from the reorganization of European business itself, evidenced by the wave of merger and takeover attempts. Many member states have embarked on public awareness campaigns to boost competitiveness of national industries. The rise to economic prominence by Japan and the NICs has generated both anxiety and a determination to meet the competitive challenge.

The new generation of leaders and voters in Europe are also different: less nationalistic, fewer memories from the war, more willing to search for European, rather than national, solutions to problems. The post-war generation has grown up within the context of an emerging European Community, motivated by a desire to see Europe reclaim its historic place at the center of global progress. Recognizing a diminishing political importance in a world dominated by two superpowers, and with dynamic development in the Pacific basin, more and more Europeans view further integration as the only means to allow Europe to assure its own destiny.

It is this generation which the Congress of Europe, in the "Hague Decalaration 1988," said could "see the (European) Commission as a future government." The Congress (with the participation in a private capacity of Mitterrand, Von Weizsaecker, Lubbers and Andreotti) spoke of the need to "shoulder Europe's own responsibility as a pillar of the Atlantic Alliance..." and called on the people of Europe to hold European elections under one law. Recent public opinion polls show widespread support for expanding the powers of EC political institutions, even at the expense of national sovereignty.

There has also been a convergence in economic thinking. The pace of change in technology, and the premium this places on structural adjustment, has left interventionist economic policies discredited. Many governments and political parties which have traditionally favored highly regulated or mixed economies have lost currency with voters. Deregulating and encouraging entrepreneurship are increasingly seen as sound policy -- the U.S. example has become a model to be adapted and adopted.

The economic benefits of a single European market have captured the attention of many. The Cecchini Report, an EC-funded study on the expected impact of the single market, indicated that full implementation of the program would raise the base line of GDP up to six percent by the mid-1990's. Benefits are expected from supply-side effects (direct cost savings from the removal of border formalities; economies of scale in production for a larger market; increased competition; greater expenditure on R&D), and demand-side effects (lower prices; greater variety of products to stimulate consumer demand; lower budgetary expenditures on government regulations). Although other studies forecast smaller gains in GDP, all foresee wide-ranging beneficial structural adjustment in Europe.

SCOPE AND IMPACT OF THE PROGRAM: EC GAINING AUTHORITY

The 1985 White Paper, "Completing the Internal Market," forms the core of the EC's 1992 workplan. The paper identifies 300 regulations (since reduced to 286) needed to remove the remaining physical, technical and fiscal barriers between member states. Although the paper is the symbol of the program, it has been supplemented by a wide variety of other measures with the same end, all justified on the basis of 1992. At the recent Hanover Summit for instance, EC leaders agreed to study the concrete steps needed to create a monetary and economic union, which implicitly entails a study of a central bank and single currency. Various sectors (telecommunications and copyright) are moving ahead on the basis of Green Papers (a commission study with recommendations for further action). EC President Delors has spoken of the need for a Community "Bill of Rights," which would take the EC into the difficult areas of welfare policy, pension plans, and worker rights. Nobody believes all aspects of the program will be in place by 1992, but significant progress toward economic, monetary and political union will have been made and momentum will continue past 1992.

Progress on the White Paper itself has surprised many. As of June 1988, the Commission had proposed 211 directives, of which more than 85 have been adopted by the EC (after approval from both the Council and the Parliament); 75 more remain to be formulated. Lord Cockfield, EC Vice President and Commissioner for the Internal Market, wants to have virtually all directives out of the Commission and before Parliament and Council by December 1988.

The single market exercise involves a massive change in regulation and policies and a significant transfer of authority from member state governments to the Community. Acknowledgement that member states were willing to concede greater sovereignty came in 1987 with the entry into force of the Single European Act. The Single Act provided for majority voting in the Council to adopt most legislation, streamlining the EC's decision-making process by removing a single member's ability to block legislation. The Act also codified the 1992 deadline for completing the single market and expanded the European Parliament's legislative role. Its passage by member countries amounted to a vote "for" Europe.

Expanded EC competence goes far beyond trade issues, and the creation of a single market will involve more than economic harmonization.

- In creating a space where individuals can move freely, the EC will move toward a common immigration policy, and will become more involved with anti-terrorism strategies and law enforcement issues, such as narcotics control.

- In pushing to remove restrictions on capital the EC has removed a key policy tool of host governments, and when capital begins to circulate freely, members will find control over monetary policy more difficult. The monetary and fiscal policies of the EC-12 will converge more.

- As the last barriers to the movement of goods are removed, intra-EC licensing of strategic goods will undoubtedly cease. We are working within COCOM to take this into account, but how far the EC will attempt to play a direct role in security policy has not been addressed in the Community.

- In deregulating, harmonizing and centralizing air transportation policy, the EC is moving to change patterns created by a labyrinth of bilateral trade negotiations.

- The recent signing of the Montreal Protocol, during which the Commission instructed member states to accept and ratify the Vienna Convention and the Protocol within a set time period, was another step in the direction of EC competence for environmental policy. Other environmental issues are under study by the Commission.

- The EC's examination of national subsidies to industry, with an aim to reduce those that distort competition, is removing the independence of action in industrial policy for members.

- We can expect to see the Commission involve itself more deeply in the future in coordinating judicial assistance, anti-trust and anti-terrorism policy, in pushing for expanded East-West trade, in harmonizing our bilateral rights with different member states under extradition treaties or under Friendship, Commerce and Navigation Treaties, and in defense procurement policy.

In many cases, we can expect the goals of "Europeanism" and a common set of standards within the Community to prevail over member state objections to encroaching Commission competence.

INHERENT BARRIERS

Significant hurdles remain as the EC proceeds to implement the single market program.

Sovereignty. Many of the program's remaining directives will be more difficult and in areas in which member states are less willing to cede national sovereignty, such as tax harmonization.

Psychological. While members in general support the formation of an integrated EC, each member country is approaching 1992 with the idea of making its industry the most competitive and will seek harmonization on its terms to minimize the cost of national adjustment. One result of this is that 1992 will come first in sectors with the greatest economic importance and least government intrusion.

Language. Translations and language instruction will become a growth industry, but the barrier of nine distinct languages is immense.

Legal and Political Systems. Different attitudes toward government will make integration more difficult. The fact that England has a legal system based on common law whereas most of the continent is based on the Napoleonic Code also makes mutual undertakings and cooperation fundamentally more difficult than in the U.S. The existence of strong federal systems (FRG) within the EC will also create problems as regions see their authority encroached upon by Brussels. Differing sets of social policies, including access to health care, retirement systems and unemployment insurance, will make social integration very difficult.

Currencies. Despite increased use of the ECU in transactions, growing pressure for a central bank, and reinforcement of the EMS, multiple currencies remain a significant barrier to economic integration.

MEMBER COUNTRY ATTITUDES AND APPROACHES

UK. The single market is the first EC program to grab Margaret Thatcher's attention. She sees "1992" as Thatcherism writ large, a vindication of free market policies and deregulation. The British, however, are careful to say the goal is "barrier-free" Europe, not "frontier-free"; they want a free market in capital and services, but want to retain border controls on goods (presumably for health reasons) and on people. That said, the UK generally believes 1992 will require little adjustment since the UK market is already quite open. HMG believes the UK should become the EC's financial center, though a truly unified and deregulated European capital market may facilitate other regional financial centers (such as Frankfurt) and Thatcher's refusal to join the EMS may disadvantage UK institutions. The UK is likely to use its veto power over the EC's push to harmonize VAT rates, and in other, non-trade areas, has tried to rein in growing EC competence. The British will be staunch allies for fair treatment for third countries, and we can expect to learn of many potentially protectionist actions from them.

Netherlands. With an already open trading system and strong U.S. presence (U.S. firms employ 10% of the Dutch workforce), the Dutch are another natural ally for fair treatment for third countries. The single market has caused Dutch politicians to review the country's generous social programs. Finance Minister

Ruding has said they should be restrained to keep Dutch industry competitive, and the government has introduced plans for a national ID card to prevent "welfare shopping" by non-nationals. With Rotterdam Port, 40% of all EC trucks and as a transit point for aviation, the Dutch will continue their traditionally strong advocacy for liberal transportation policies.

Belgium and Luxembourg. Belgium got a taste of 1992 in Carlo de Benedetti's raid on Societe Generale de Belgique earlier this year. In response, government and industry have taken steps to restrict takeovers which are hostile or which are in "strategic sectors." Belgium reexports many of its imported goods, both with and without added value, and so could be a voice for unrestrictive standards and free trade, though it has tended to be a follower and not a leader in the EC process. Luxembourg has promoted itself as a banking center by stressing the secrecy of accounts and the country's low tax rates, but EC rules may mitigate against the former. The Duchy has also moved more aggressively into audiovisual services and telecommunications in preparation for 1992. Belgium and Luxembourg will have to end their dual currency exchanges after 1992.

Denmark. Political opposition to the EC, always strong in Denmark, received a setback in the referendum two years ago over implementation of the Single European Act. Significant steps have been taken to liberalize the financial services sector, including permitting mortgage lending abroad and ending the separation between banks and insurers. The Danish public insist on strict Danish standards on the environment and human safety. Denmark is the access point to the EC for the Nordic countries, and Norway and Sweden have been making the most of their connection. Denmark has one of the highest indirect tax rates in the EC, but is hoping the UK will take the heat to prevent EC harmonization of tax rates.

Ireland. Ireland is the only neutral country in the EC and does not participate in NATO, in the WEU, or in COCOM. As a neutral, the Irish will support the view that the EC should stick to free trade and avoid politics. While awareness of 1992 is scant, there is no political opposition, and the Minister of Trade has said that Ireland has problems with only five of the 300 directives (all concerning taxes). The Irish have implemented all the directives so far (some with extensions), since domestic approval of EC Council decisions is automatic. As one of the EC's disadvantaged regions, Ireland receives a great deal of aid. Heavily reliant on foreign investment, Ireland may be another ally for fair treatment for third country investors.

Federal Republic of Germany. Germans tend to support 1992 in general but to resist specific demands that would require significant changes in their economic policies, which they view as having been very successful. Authorities at either the federal or Laender level are likely to oppose adjustments to monetary policy, health and welfare standards, or control over education and broadcasting. Still, FRG officials realize that high wages and taxes might be a strong disincentive to investment in an open European market, and tax reform is being undertaken. Certain sectors, such as transportation (where the government fixes truckers' prices and costs) and energy (where high-priced German coal is required) could be hard hit by free competition. Strong union opposition to certain directives has been translated into FRG foot-dragging in the Council. German business, if not eager for change, nonetheless believes it will be competitive in a future integrated market.

Italy. Politicians and the public support 1992, but Italian authorities are acutely aware that decaying infrastrucure, unreliable services, high public debt, aggressive unions and poor administration could severely disadvantage Italian business in the single market program. Italy has 237 EC directives which still require implementation (one on medicines dates from 1965), and plans to apply liberally for extensions on future directives. Industry maintains it could adhere to the directives with little difficulty, but the government is having a hard time adjusting. Nevertheless, the EC and the single market may prompt reforms otherwise unattainable. Certainly the prospect of free movement of capital has concerned authorities, since Italy's budget deficits would be more costly to fund were it not for the high captive savings of Italians. In the longer run, the Italian public may be the most supportive of stronger political institutions in Brussels -- a recent EC poll showed Italians were by far the strongest believers (69%) that "the European Parliament ought to have the power to pass laws directly applicable to each member country."

France. The French have been avid public supporters of 1992. A recent poll found around half of British and German insurers knew about 1992, whereas 100% of the French respondents understood it. This support stems from a concern that Europe (and France) are falling behind in economic power; from a perception that the program is an extension of pragmatic economic policies adopted in France since the failed socialist experiment of 1981-82; and because the French see a strengthened EC as a vehicle for exercising influence on a world scale . France has pushed to form a Franco-FRG security axis, to strengthen the WEU, and been in the forefront of strengthened political integration. Despite France's recent commitment to free market economics, however, France has not dropped all its traditional tendencies. Dirigisme may be dying, but dirigistes live on. Economically, France seems fairly well positioned to take advantage of the single market. Its agriculture and high tech industries are strong, it has one of the fastest growing and best educated workforces, and it has removed many of the shackles on business. France will face serious competition in the professions and in the financial sector, however.

Greece. Greece is still somewhat ambivalent about the process. Greece had the most complaints lodged against it in 1986, and in conjunction with Spain and Portugal, has requested the most (and longest) derogations from EC directives. The economy faces an uphill struggle: central budget expenditures account for 50% of GDP, public debt is roughly equal to GDP, and Greek industry has an average debt/equity ratio of 6:1. EC funds provided 4% of GDP last year and Greece expects that percentage to rise to 6.5% by 1992. Still, investor confidence is on the rise and Papandreou has made 1992 part of his platform. Priorities during the present Greek EC presidency are a push for a common Community social policy (generally taken to mean worker safety standards and environmental issues, but which could include welfare and medical care harmonization), greater aid flows to the poor regions of the EC, and monetary union. Papandreou has promised that the drachma would be folded into the EMS by next year. The Greeks will resist any EC transport policy which restricts cabotage. Greece has a more political agenda for the EC than most, but the U.S. can expect northern European sensibilities to prevail.

Spain. The Spaniards have become ardent integrationists, although government coordination for 1992 is still weak. In a sense, adjusting to 1992 directives is easier for Spain and Portugal since they are in the process of conforming their laws and regulations to the EC anyway. Investment in Spain is rocketing, with increases of 43% in 1986 and 88% in 1987. This has put upward pressure on the peseta (still not part of the EMS) and has recently led to the reimposition of currency controls. While the U.S. has had significant problems related to Spain's accession to the EC (quantitative restrictions, corn/sorghum exports), generally the single market program in Spain will benefit U.S. business. Intellectual property rights are being strengthened along the lines of the EC framework and an end to the prohibition of foreign ownership of banks has been promised.

Portugal. The post-revolutionary leadership is European in outlook, and willing to let Portuguese economic policy be driven by EC directives. PM Cavaco Silva recently declared that Portugal may even have to revise its constitution ("to remove the Marxist bias") in light of 1992. Since Portugal was an EFTA country before acceding to the EC (unlike Spain), it has had no problem in adjusting its tariffs. On other directives, especially in the financial services sector, Portugal is counting on lengthy extensions. Much improvement in infrastructure is needed. EC aid contributes some $2 billion a year, and government officials recently said they would only fund investment projects which the EC is also funding. Portugal will seek to protect its textile industry, which may lead to tensions as the EC prohibits intra-Europe quotas on textiles.

NON-EC EUROPEANS AFFECTED

The six members of EFTA -- Sweden, Norway, Austria, Switzerland, Iceland and Finland -- are increasingly concerned they may find themselves in a European limbo. To varying degrees, the governments are examing closer ties with the Community, including membership. In Norway, where EC membership has been a divisive issue since the "no's" won the 1972 referendum, there is again serious consideration of joining. There is bipartisan support in Austria for applying, and such a move is increasingly likely. Swedish business and industry are concerned about being excluded from the EC market and have been investing heavily in EC states to keep their "foot in the door," although EC membership is not under serious consideration by the government. Malta has said it would apply for membership in the EC some time after 1992.

The EC discussed in depth earlier this year further enlargement. Given the difficulty the EC would encounter in absorbing Turkey, which has already applied, and in creating the single market, the Community will almost certainly not add new members until after 1992. But the effect of the program on the non-EC Europeans is to push them to bring their national standards and regulations into harmony wth EC norms, which they are doing.

CONFIDENTIAL

OFFICE OF THE UNITED STATES
TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON
20506

August 3, 1988

MEMORANDUM

TO: ECONOMIC POLICY COUNCIL

FROM: THE TRADE POLICY REVIEW GROUP

SUBJECT: Meat Import Limitations

ISSUE

USDA'S projected fourth quarterly estimate of 1988 meat imports subject to the Meat Import Act of 1979 will exceed the level which will automatically trigger imposition of meat import quotas. The estimate, which must be published before October 1, is currently projected at 1,565 million pounds, about 40 million pounds above the trigger level.

RECOMMENDATION

It is the consensus of the TPRG that the EPC should direct USTR, with USDA assistance, to negotiate voluntary restraint agreements (VRA's) with Australia and New Zealand. In order to be effective, the VRA's should be completed before September 15 and be designed to hold USDA's final estimate of 1988 imports below the trigger level.

Note: There was some discussion at the TPRG concerning the timing for initiation of VRA negotiations. Since USDA's quarterly import estimate will be published by October 1, an argument was made that a decision to negotiate VRA's should await release of that figure. However, USDA must begin its preparation of a fourth quarterly estimate by September 15, a process that would be complicated if VRA's were not concluded by that date. The majority of TPRG agencies concur that the current USDA figures accurately indicate that the trigger level will be exceeded and that VRA negotiations should begin immediately.

Classified by: Wm.J.Maroni
Declassify on: OADR

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OPTIONS

A. SEEK VOLUNTARY RESTRAINT AGREEMENTS WITH AUSTRALIA AND NEW ZEALAND

With interagency concurrence, USTR would seek (VRA's) with the two major supplying countries--Australia and New Zealand. These two countries typically supply 60-70 percent of U.S. meat imports subject to quota. VRA's would be negotiated at levels designed to hold 1988 U.S. meat imports below the trigger level.

If VRA's could not be concluded with either or both of these countries by September 15, USDA would begin processing a fourth quarterly estimate (currently projected at above the trigger level). When the estimate is published (before October 1), the only issue left would be whether to impose quotas or to impose quotas and suspend them.

In order to insure sufficient opportunity to negotiate and conclude VRA's prior to September 15, a decision is needed on this matter as soon as possible.

B. IMPOSE AND SUSPEND QUOTAS

Although the President is required to invoke quotas when the trigger level is reached or surpassed, he may under certain circumstances suspend the quotas after providing a 30-day period for public comment. Under this scenario, the President--after the requisite 30-day notice period--may set quotas aside completely or establish a new quota level.

C. DO NOTHING/QUOTAS AUTOMATICALLY IMPOSED

The President will be required to impose country-by-country quotas upon the release of USDA's fourth quarterly estimate. Quotas will be imposed at the base quota level--1,386.8 million pounds or approximately 10 percent below the trigger level.

Without further action, the quotas will remain in effect through the remainder of the calendar year.

PROS AND CONS FOR VARIOUS OPTIONS

Option A -- Seek VRA's with Australia and New Zealand

Pros

- Avoids formal quotas, and therefore, potential GATT issue.
- Minimizes inconsistencies in U.S. positions in Uruguay Round, Canada FTA, and bilateral discussions with Japan and Korea.
- Acceptable to U.S. cattle industry.
- Limits impact on importers, processors, and consumers.
- Would allow Australia and New Zealand to exceed the level of exports which would be allowed under quota conditions.

Cons

- While softer than quotas, VRA's would still be viewed as inconsistent with the position the U.S. has taken in Uruguay Round agricultural talks and in bilateral disputes with Korea and Japan.
- Agreement by Australia and New Zealand to VRA's is not certain at this time, and will depend on the export levels proposed. New Zealand will probably object to more than token restraint. Australia will object if it perceives that it is being expected to shoulder all of the burden.

Option B -- Impose and Suspend Quotas

Pros

- Consistent with U.S. Uruguay Round proposal.
- Will minimize disruptions in trade.
- Does not damage our position in discussions with Canada, Japan, and Korea.
- Minimizes potential damage to importers, processors, and consumers.
- Avoids possible GATT issue.

Cons

- o Strongly opposed by U.S. cattlemen who support the Meat Import Law and who view it as their only form of Government support.
- o Would require a 30 to 45 day period to permit public comment and analysis of comments; some trade disruption could occur.
- o Requires Presidential certification that the suspension is necessary due to one of several reasons such as national security, overriding economic interests of the United States, or a meat shortage.

Option C -- Do Nothing/Quotas Automatically Imposed

Pros

- o Will satisfy domestic cattle industry.

Cons

- o Likely to disrupt trade with a number of countries, including Canada and CBI countries.
- o Could provide the basis for a GATT challenge of our Meat Import Law.
- o Inconsistent with U.S. Uruguay Round proposal on agriculture.
- o Likely to undercut our position on beef issues with Japan and Korea.
- o Could generate opposition among importers, processors, and consumers.

BACKGROUND

The Meat Import Act of 1979 (Appendix I) provides for the imposition of import controls on certain fresh, chilled, and frozen beef, veal, mutton, and goat meat products. The law mandates quantitative import restrictions if the Secretary of Agriculture estimates that imports will exceed the trigger level.

A. Computation of Quota and Trigger Level

The Act provides for a basic import level of 1,204.6 million pounds of meat products covered by the law. This base quantity--which represents the average import level for the years 1968-77--is modified annually by two factors: (1) a production adjustment factor; and (2) a counter-cyclical factor.

The production adjustment factor is a 3-year moving average of the domestic production of meats covered in the present law divided by average U.S. production of such meats during the 1968-77 period. The counter-cyclical factor is a 5-year moving average of the U.S. per capita supply of cow beef, divided by a 2-year moving average of the per capita cow beef supply.

Once the adjusted base level for a particular year has been calculated, the key point of reference for import estimates is the "trigger level", which is 110 percent of the adjusted base quantity. It is only when imports are expected to equal or exceed the 110 percent figure that quotas must be imposed.

B. Import Estimates

The Secretary of Agriculture must publish an adjusted base quantity before January 1 of each coming year. The Secretary must also publish quarterly import estimates of meat products covered by the Meat Import Act that would enter the United States during the year in the absence of quantitative restrictions. The first quarterly import estimate is published along with the year's adjusted base quantity level before January 1, with subsequent estimates appearing before April 1, July 1, and October 1.

C. Presidential Authority

If the USDA estimate of imports equals or exceeds 110 percent of the adjusted base quota (the trigger level), the President must proclaim that total imports for the year will be limited to the base quantity level, but not less than 1,250 million pounds. Once import quotas are imposed, the President has limited authority to suspend such quotas. When the counter-cyclical factor is 1.0 or greater, as it is for 1988, the President may suspend limitations on meat imports or increase the import level by: (1) proclaiming that such action is required due to the overriding economic or national security interests of the United States (giving special weight to the importance to the nation of the economic well-being of the U.S. cattle industry); or (2) determining that the supply of meats covered by the law will be insufficient to meet U.S. demand at reasonable prices if import limits are in effect.

The law requires that the President publish in the Federal Register a statement of his intent to lift import limitations and allow a 30-day comment period before taking action to suspend quotas.

D. Voluntary Restraint Agreements

In a number of past years when USDA estimates indicated that imports likely would exceed the trigger level, the U.S. Government negotiated a program of VRA's with supplying countries to insure that total imports of meats covered by the law would not exceed the trigger level. VRA's have also been used to control imports after quotas have been imposed and suspended.

Authority for negotiation of VRAs is found in Section 204 of the Agricultural Act of 1956. The Secretary of Agriculture has the delegated authority to issue regulations to ensure compliance with the import levels agreed upon in VRA's. Appendix II shows a history of actions taken under the Meat Import Act, including VRA's. Appendix III provides relevant import statistics.

Attachments

Public Law 96-177
96th Congress

An Act

To modify the method of establishing quotas on the importation of certain meat, to include within such quotas certain meat products, and for other purposes.

Dec. 31, 1979
[H.R. 2727]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 2 of the Act of August 22, 1964, entitled "An Act to provide for the free importation of certain wild animals, and to provide for the imposition of quotas on certain meat and meat products" (19 U.S.C. 1202 note) is amended to read as follows:

Meat imports, quota modifications.

"SEC. 2. (a) This section may be cited as the 'Meat Import Act of 1979'.

Meat Import Act of 1979.

"(b) For purposes of this section—

Definitions.

"(1) The term 'entered' means entered, or withdrawn from warehouse, for consumption in the customs territory of the United States.

"(2) The term 'meat articles' means the articles provided for in the Tariff Schedules of the United States (19 U.S.C. 1202) under—

"(A) item 106.10 (relating to fresh, chilled, or frozen cattle meat);

"(B) items 106.22 and 106.25 (relating to fresh, chilled, or frozen meat of goats and sheep (except lambs)); and

"(C) items 107.55 and 107.62 (relating to prepared and preserved beef and veal (except sausage)), if the articles are prepared, whether fresh, chilled, or frozen, but not otherwise preserved.

"(3) The term 'Secretary' means the Secretary of Agriculture.

"(c) The aggregate quantity of meat articles which may be entered in any calendar year after 1979 may not exceed 1,204,600,000 pounds; except that this aggregate quantity shall be—

"(1) increased or decreased for any calendar year by the same percentage that the estimated average annual domestic commercial production of meat articles in that calendar year and the 2 preceding calendar years increases or decreases in comparison with the average annual domestic commercial production of meat articles during calendar years 1968 through 1977; and

"(2) adjusted further under subsection (d).

For purposes of paragraph (1), the estimated annual domestic commercial production of meat articles for any calendar year does not include the carcass weight of live cattle specified in items 100.40, 100.43, 100.45, 100.53, and 100.55 of such Schedules entered during such year.

"(d) The aggregate quantity referred to in subsection (c), as increased or decreased under paragraph (1) of such subsection, shall be adjusted further for any calendar year after 1979 by multiplying such quantity by a fraction—

"(1) the numerator of which is the average annual per capita production of domestic cow beef during that calendar year (as

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estimated) and the 4 calendar years preceding such calendar year; and

"(2) the denominator of which is the average annual per capita production of domestic cow beef in that calendar year (as estimated) and the preceding calendar year.

"Domestic cow beef."

For the purposes of this subsection, the phrase 'domestic cow beef' means that portion of the total domestic cattle slaughter designated by the Secretary as cow slaughter.

"(e) For each calendar year after 1979, the Secretary shall estimate and publish—

"(1) before the first day of such calendar year, the aggregate quantity prescribed for such calendar year under subsection (c) as adjusted under subsection (d); and

"(2) before the first day of each calendar quarter in such calendar year, the aggregate quantity of meat articles which (but for this section) would be entered during such calendar year.

In applying paragraph (2) for the second or any succeeding calendar quarter in any calendar year, actual entries for the preceding calendar quarter or quarters in such calendar year shall be taken into account to the extent data is available.

"(f)(1) If the aggregate quantity estimated before any calendar quarter by the Secretary under subsection (e)(2) is 110 percent or more of the aggregate quantity estimated by him under subsection (e)(1), and if there is no limitation in effect under this section for such calendar year with respect to meat articles, the President shall by proclamation limit the total quantity of meat articles which may be entered during such calendar year to the aggregate quantity estimated for such calendar year by the Secretary under subsection (e)(1); except that no limitation imposed under this paragraph for any calendar year may be less than 1,250,000,000 pounds. The President shall include in the articles subject to any limit proclaimed under this paragraph any article of meat provided for in item 107.61 of the Tariff Schedules of the United States (relating to high-quality beef specially processed into fancy cuts).

19 USC 1202 note.

"(2) If the aggregate quantity estimated before any calendar quarter by the Secretary under subsection (e)(2) is less than 110 percent of the aggregate quantity estimated by him under subsection (e)(1), and if a limitation is in effect under this section for such calendar year with respect to meat articles, such limitation shall cease to apply as of the first day of such calendar quarter. If any such limitation has been in effect for the third calendar quarter of any calendar year, then it shall continue in effect for the fourth calendar quarter of such year unless the proclamation is suspended or the total quantity is increased pursuant to subsection (g).

Publication in Federal Register.

"(g) The President may, after providing opportunity for public comment by giving 30 days' notice by publication in the Federal Register of his intention to so act, suspend any proclamation made under subsection (f), or increase the total quantity proclaimed under such subsection, if he determines and proclaims that—

"(1) such action is required by overriding economic or national security interests of the United States, giving special weight to the importance to the Nation of the economic well-being of the domestic cattle industry;

"(2) the supply of meat articles will be inadequate to meet domestic demand at reasonable prices; or

"(3) trade agreements entered into after the date of enactment of this Act insure that the policy set forth in subsections (c) and (d) will be carried out.

Any such suspension shall be for such periods, and any such increase shall be in such amount, as the President determines and proclaims to be necessary to carry out the purposes of this subsection.

"(h) Notwithstanding the previous subsections, the total quantity of meat articles which may be entered during any calendar year may not be increased by the President if the fraction described in subsection (d) for that calendar year yields a quotient of less than 1.0, unless—

"(1) during a period of national emergency declared under section 201 of the National Emergencies Act of 1976, he determines and proclaims that such action is required by overriding national security interests of the United States; 50 USC 1621.

"(2) he determines and proclaims that the supply of articles of the kind to which the limitation would otherwise apply will be inadequate, because of a natural disaster, disease, or major national market disruption, to meet domestic demand at reasonable prices; or

"(3) on the basis of actual data for the first two quarters of the calendar year, a revised calculation of the fraction described in subsection (d) for the calendar year yields a quotient of 1.0 or more.

Any such suspension shall be for such period, and any such increase shall be in such amount, as the President determines and proclaims to be necessary to carry out the purposes of this subsection. The effective period of any such suspension or increase made pursuant to paragraph (1) may not extend beyond the termination, in accordance with the provisions of section 202 of the National Emergencies Act of 1976, of such period of national emergency, notwithstanding the provisions of section 202(a) of that Act. 50 USC 1622.

"(i) The Secretary shall allocate the total quantity proclaimed under subsection (f)(1) and any increase in such quantity provided for under subsection (g) among supplying countries on the basis of the shares of the United States market for meat articles such countries supplied during a representative period. Notwithstanding the preceding sentence, due account may be given to special factors which have affected or may affect the trade in meat articles or cattle. The Secretary shall certify such allocations to the Secretary of the Treasury.

"(j) The Secretary shall issue such regulations as he determines to be necessary to prevent circumvention of the purposes of this section. Regulations.

"(k) All determinations by the President and the Secretary under this section shall be final. Determinations.

Study, report and recommendations to congressional committees.

"(l) The Secretary of Agriculture shall study the regional economic impact of imports of meat articles and report the results of his study, together with any recommendations (including recommendations for legislation, if any) to the Committee on Ways and Means of the House of Representatives and to the Committee on Finance of the Senate not later than June 30, 1980.".

Effective date. 19 USC 1202 note.

SEC. 2. This Act shall take effect January 1, 1980.

Approved December 31, 1979.

LEGISLATIVE HISTORY:

HOUSE REPORT No. 96-238 (Comm. on Ways and Means).
SENATE REPORT No. 96-465 (Comm. on Finance).
CONGRESSIONAL RECORD, Vol. 125 (1979):
Nov. 13, 14, considered and passed House.
Dec. 18, considered and passed Senate.
WEEKLY COMPILATION OF PRESIDENTIAL DOCUMENTS, Vol. 15, No. 52:
Dec. 31, Presidential statement.

APPENDIX B: OPERATION OF U.S. MEAT IMPORT LAW 1/ 1965-1984 (IN MILLION POUNDS)

YEAR	ADJUSTED BASE QUANTITY	TRIGGER LEVEL	ACTUAL IMPORTS	IMPORT PROGRAM
1965	848.7	933.6	613.9	NO RESTRICTIONS.
1966	890.1	979.1	823.4	NO RESTRICTIONS.
1967	904.6	995.1	894.9	NO RESTRICTIONS.
1968	950.3	1045.3	1001.0	FORMAL VRA'S WITH AUSTRALIA AND NEW ZEALAND NEGOTIATED IN AUG.; OTHER EXPORTERS ASKED NOT TO EXCEED SCHEDULED SHIPMENTS.
1969	988.0	1086.8	1084.1	VRA'S NEGOTIATED WITH ALL SUPPLIERS EXCEPT CANADA AND UNITED KINGDOM.
1970	998.8	1098.7	1170.6	VRA PROGRAM NEGOTIATED BELOW TRIGGER LEVEL; QUOTAS IMPOSED AND SUSPENDED AT MIDYEAR AND NEW RESTRAINT LEVELS ESTABLISHED FOR PARTICIPATING COUNTRIES. SECTION 204 USED TO CONTROL TRANSSHIPMENTS THROUGH CANADA.
1971	1025.0	1127.5	1132.6	QUOTAS IMPOSED AND SUSPENDED; VRA PROGRAM NEGOTIATED AT REVISED 1970 LEVEL.
1972	1042.4	1146.6	1355.5	VRA PROGRAM NEGOTIATED, BUT PROGRAM SUSPENDED AT MIDYEAR.
1973	1046.8	1151.5	1355.6	QUOTAS IMPOSED AND SUSPENDED; NO RESTRICTIONS.
1974	1027.9	1130.7	1079.1	QUOTAS IMPOSED AND SUSPENDED; NO RESTRICTIONS.
1975	1074.3	1181.7	1208.9	VRA PROGRAM NEGOTIATED WITH MOST SUPPLYING COUNTRIES.
1976	1120.9	1233.0	1231.7	VRA PROGRAM NEGOTIATED, BUT QUOTAS REQUIRED IN LAST QUARTER.
1977	1165.4	1281.9	1250.2	VRA PROGRAM NEGOTIATED, SUPPORTED BY LETTER OF UNDERSTANDING WITH CANADA.
1978	1183.9	1302.3	1485.5	VRA PROGRAM NEGOTIATED AT BEGINNING OF YEAR BUT QUOTAS IMPOSED AND SUSPENDED TO ALLOW A 200-MILLION POUND INCREASE IN THE VRA PROGRAM IN JUNE.
1979	1131.6	1244.8	1533.7	QUOTAS IMPOSED AND SUSPENDED, VRA PROGRAM NEGOTIATED ABOVE TRIGGER LEVEL.
1980	1516.0	1667.6	1431.2	NO RESTRICTIONS.
1981	1316.0	1447.0	1235.7	NO RESTRICTIONS.
1982	1181.8	1300.0	1319.6	VRA PROGRAM NEGOTIATED WITH AUSTRALIA AND NEW ZEALAND AND A LETTER OF UNDERSTANDING SIGNED WITH CANADA FOR FOURTH QUARTER.
1983	1119.0	1231.0	1240.1	VRA PROGRAM NEGOTIATED WITH AUSTRALIA AND NEW ZEALAND AND A LETTER OF UNDERSTANDING SIGNED WITH CANADA FOR FOURTH QUARTER.
1984	1117.0	1228.7	1141.1 2/	NO RESTRICTION
1985	1199.0	1319.0		

1/ PL 88-482 FROM 1965 AMENDED BY PL 96-177 EFFECTIVE 1980

2/ PRELIMINARY.

APPENDIX III

United States Department of Agriculture

Foreign Agricultural Service

Washington, D.C. 20250

U.S. Customs Service Monitoring of Meat Subject to the Meat Import Law, Preliminary January 1, 1988 through July 30, 1988

	Accumulative Approximate Charges ---------- 1,000 lbs. ----------	
Countries	Preliminary 1988 Week Ending July 30	1987 Week Ending August 1
Australia	515,462	430,956
Belize	- - -	31
Canada	67,807	87,255
Costa Rica	25,525	30,438
Dominican Republic	16,139	10,578
El Salvador	1,478	822
Guatemala	7,938	6,080
Honduras	9,739	6,459
New Zealand	293,314	293,085
Panama	- - -	- - -
Sweden	679	1,637
European Community	3,058	3,513
Guam	- - -	437
TOTAL	941,133	870,390

U.S. Meat Import Law
1987 IMPORTS AND 1988 PROGRAMS
(Million Pounds -- Product Weight)

	1987 IMPORTS	1988 VOLUNTARY RESTRAINTS	1988 QUOTAS	1988 WITHOUT RESTRAINTS
Australia	739.2	795.0	694.8	840.0
New Zealand	438.7	445.0	385.7	450.0
Canada	152.6	135.0	160.1	135.0
Guatemala	19.4	22.5	18.5	22.5
Honduras	18.9	27.0	38.1	27.0
Costa Rica	57.9	55.0	60.8	55.0
El Salvador	2.0	3.0	2.2	3.0
Domin. Rep.	20.5	25.0	12.6	25.0
Panama	0.0	0.0	0.0	0.0
Belize	0.1	0.1	0.2	0.1
(Subtotal C.A.)	(118.8)	(132.6)	(132.4)	(132.6)
Europ. Comm.	6.5	6.0	11.0	6.0
Other	3.9	1.4	2.8	1.4
TOTAL	1,459.7	1,515.0	1,386.8	1,565.0

1987 MEAT IMPORTS AND FOURTH ESTIMATE OF 1988
MEAT IMPORTS UNDER P.L. 88-482

(Million Pounds--Product Weight)

COUNTRY	Imports	First Quarterly Estimate	Second Quarterly Estimate	Third Quarterly Estimate	Proposed Fourth Quarterly Estimate
	1987	1988 1/	1988 1/	1988 1/	1988 1/
Australia	739.2	750.0	760.0	815.0	840.0
New Zealand	438.7	450.0	450.0	440.0	450.0
Canada	152.6	150.0	145.0	120.0	135.0
Central America	118.8	113.1	114.3	127.1	132.6
EC	6.5	8.0	7.0	6.5	6.0
Other	3.9	3.9	3.7	1.4	1.4
Total	1,459.7	1,475.0	1,480.0	1,510.0	1,565.0

1/ Estimate in the absence of restraints under the Meat Import Law.

REPORT OF THE INTERAGENCY DROUGHT POLICY COMMITTEE ON DROUGHT CONDITIONS AND THE FEDERAL RESPONSE

July 15, 1988

This report reviews the current status of the drought affecting much of the Nation, describes the most serious impacts, and outlines the Federal measures being implemented to alleviate its effects. The Interagency Drought Policy Committee prepared this report at the request of the President.

I. DROUGHT OVERVIEW

The drought has affected nearly every region of the United States. Precipitation is less than 50 percent of normal since April in much of the central United States, an area covering the Northern Plains, Lake States, Corn Belt, and parts of the Southeast. About one-half of the Nation has received less than 75 percent of normal precipitation. Streamflows are below normal at 41 of the 43 "Large River" index stations across the country.

The drought, accompanied by abnormally high temperatures, has reduced this year's harvest of wheat, soybeans, corn, and other feed grains. It is the most severe drought on record at this stage of the growing season. While July rains have eased the dry conditions in some parts of the Great Plains and Delta, conditions have worsened in the eastern Corn Belt and Southeast where crops are now in the critical growth stage. Prices for several major commodities are well above spring levels and are highly volatile. Forage supplies have been significantly reduced. With higher feed prices and inadequate forage supplies, some livestock producers are being forced to liquidate herds at lower prices. We continue to expect food prices to rise by about an additional 1 percent in 1988 and 2 percent in 1989 due to the drought.

The drought also is affecting the Nation's forests. Fire conditions in the Nation's forests have reached critical stages in both eastern and western States. The potential for major wildfire activity is greater now than at this time last year, a severe fire year. Thus far in 1988, over 56,000 wildfires have been reported compared to 37,000 at this time last year. However, fewer acres have been affected. High rates of tree seedling mortality, reduced growth, and losses due to insects will add to forestry losses. Some forests may require several years of normal precipitation to recover.

The quality and quantity of the Nation's surface water resources have been greatly reduced. The flow of the Mississippi River was 61 percent below normal in June, a record low. The Columbia River was also at a record low.

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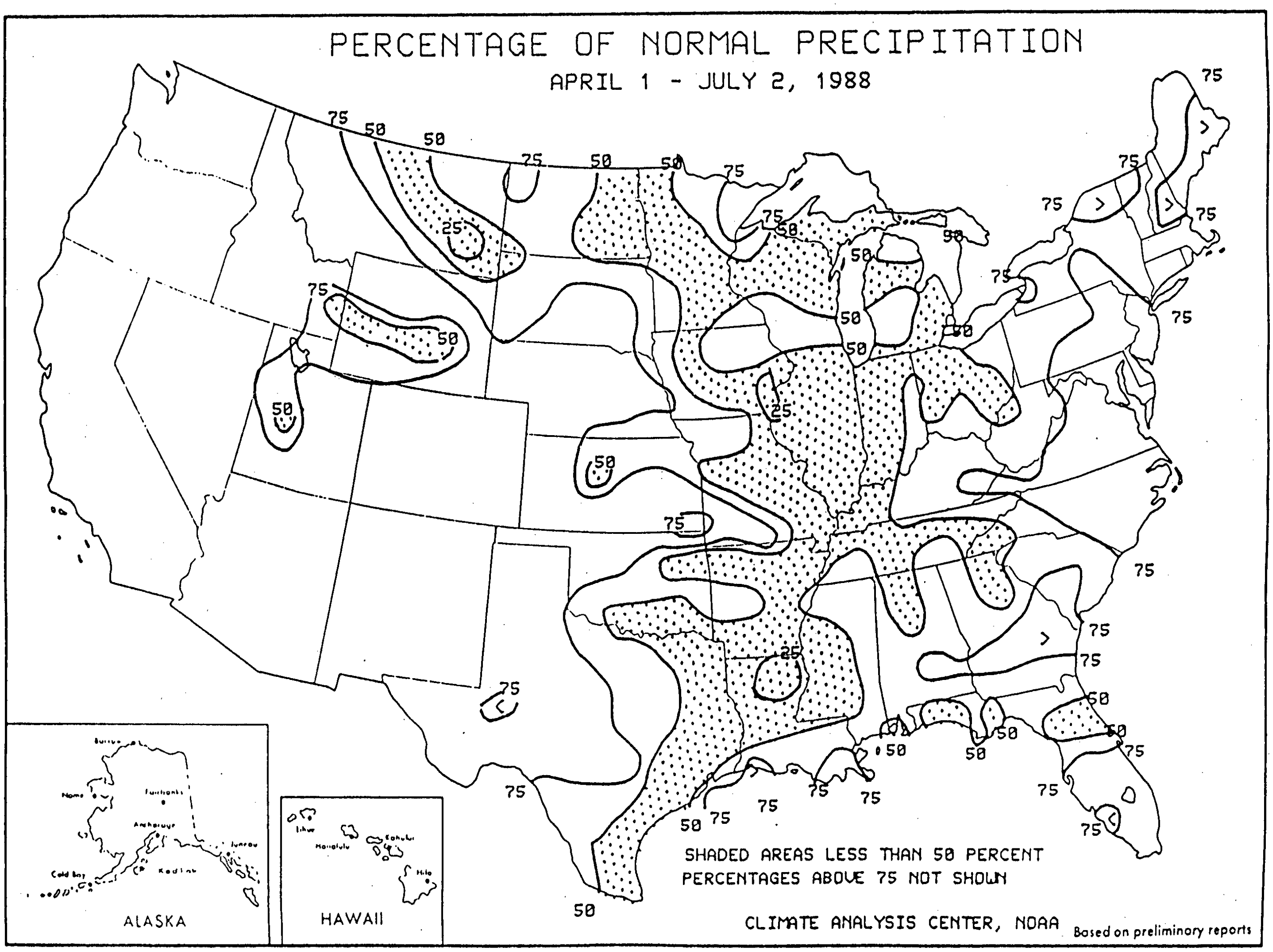
* This is the second report on the 1988 drought and its impact on the Nation. An Interim Report was submitted to The President on July 1, 1988.


PERCENTAGE OF NORMAL PRECIPITATION
APRIL 1 - JULY 2, 1988
SHADED AREAS LESS THAN 50 PERCENT
PERCENTAGES ABOVE 75 NOT SHOWN
CLIMATE ANALYSIS CENTER, NOAA
Based on preliminary reports
ALASKA
HAWAII

As of July 14, the Ohio River flow was 75 percent below normal and the Missouri River nearly 55 percent below normal. Low water has greatly impaired barge transportation as a result of channel closings, reduced loads, and smaller tows. Hydroelectric plants operated by the Tennessee Valley Authority are operating at about 55 percent of capacity due to reduced flows and plants in the Northwest are also affected. Reduced streamflows are causing concerns about water quality and the adequacy of municipal water supplies in some locations. With higher water temperatures and pollution concentrations in lakes and rivers, fish populations will be reduced. Other water-dependent wildlife and recreation facilities will also be adversely affected.

U.S. Weather Outlook

The 30-day outlook for mid-July to mid-August indicated continued dry, hot weather over much of the interior United States. Precipitation is expected to be below normal over the Corn Belt, Lake States, Northern Plains, and interior Southeast. Temperatures are expected to be warmer than normal over an even larger area stretching into the Mountain States in the West and into the mid-Atlantic States in the East. If this forecast materializes, it means continued stress of major spring crops and further reductions in yields.

Global Crop and Weather Outlook

Despite the North American drought, weather and crop conditions are generally favorable elsewhere around the world. In the aggregate, foreign crop supplies will be large in 1988. Foreign coarse grain production will be a record as will foreign production of soybeans. Wheat and cotton production overseas will be the second highest on record. Overall, foreign supplies will buffer the market impacts of the drought in the United States as foreign exporting countries will fill more of importing countries' needs.

Like the United States, Canada is faced with much the same situation in the Prairie Provinces--an extended period of hot, dry weather. Without extensive and timely rains, the Canadian wheat crop could be down sharply. In the USSR, periodic hot weather and a drying trend since early June in the major spring wheat area is stressing crops. However, favorable growing conditions in the Western USSR are expected to result in a moderate rise in total grain output from the large 1987 crop. Weather conditions in China are generally favorable for good crop development. However, excessive rain has fallen in southeast rice areas, and unfavorable spring dryness in the north China Plain has affected winter grains. An excellent wheat crop is still forecast. In India, grain supplies have been sharply reduced going into the 1988/89 season because of the 1987 drought. The 1987 rice and coarse grain crops were the smallest since 1982 and 1965, respectively. The drought also reduced irrigation supplies for the 1988 winter wheat crop. In Brazil and Argentina, oilseed production in 1988/89 is expected to show a large gain over last year's record level.

II. IMPACTS OF THE U.S. DROUGHT

Agriculture

Production and Prices. In July commodity markets have continued to respond to the likelihood of smaller crops because of the drought. Crop prices have been very volatile in response to changing crop conditions. Cash prices for wheat and corn are now up 25 to 50 percent since early May and soybean prices are up 35 percent. Cow prices are down 10 percent from early May reflecting distress sales because of insufficient forage supplies to maintain herds in some areas.

Pasture and range conditions deteriorated further in June. The U.S. pasture and range condition rating on July 1 was the worst for that date since records started in 1921. Pastures in 31 states were rated very poor or worse on July 1; last year there were no states in that category. About 63 million acres of hay will be harvested this year, up 3 percent from 1987. Approval of haying and grazing on set-aside acreage has helped to increase hay production. Nationally, hay prices in June were up 22 percent from last year, but in North Dakota the price was up nearly 70 percent.

Short forage supplies have forced some producers to cull beef and dairy cattle herds. Cow sales have increased and U.S. weekly cattle slaughter is running 5 percent above a year ago while slaughter in some regions is much further ahead of last year. Larger marketings have caused utility cow prices to fall from around $50 per cwt in early May to $45 per cwt in mid-July.

This year's grain and soybean harvests will be smaller because of the drought. However, total supplies--stocks at the start of the 1988 season plus production--are expected to be adequate and more than enough to meet the needs of domestic users and our foreign customers although commodity prices will be higher. USDA's crop production report released on July 12 estimated U.S. crop supplies for 1988/89 as follows:

	Carryin		Production		Total Supply*		
	Avg. 1985-87	1988P	Avg. 1985-87	1988P	Avg. 1985-87	1988P	Percent of use
	(million bushels)						
Corn	3,523	4,365	8,063	5,200	11,588	9,570	133
Barley	303	321	576	291	886	632	137
Grain sorghum	528	725	933	560	1,461	1,285	186
Oats	166	112	427	255	627	427	125
Soybeans	429	290	1,981	1,650	2,410	1,940	108
Wheat	1,717	1,266	2,207	1,840	3,924	3,121	127

*Includes imports

The winter wheat harvest was about 75 percent complete as of July 10. Winter wheat normally accounts for about 75 percent of total U.S. wheat production.

The spring wheat crop is in bad shape with 70 percent of the crop rated in poor-to-very poor condition due to the drought. In North Dakota, where 80 percent of the durum wheat is normally produced, the wheat crop has been especially hard hit.

The total wheat crop is projected to be down 13 percent from last year but relatively large stocks carried into the 1988/89 marketing year are bolstering supplies. Supplies for 1988/89 are expected to be 3.1 billion bushels, down 20 percent from the average of the past three years, but equal to 127 percent of total use. Farm-level wheat prices are expected to average between $3.45 and $3.95 per bushel for this marketing year compared with $2.57 per bushel during the 1987/88 marketing year.

The corn crop is generally rated in poor-to-fair condition. In 10 of 17 major corn producing states, half or more of the corn crop is rated poor or very poor. This fall's corn harvest is estimated to be 5.2 billion bushels, down 26 percent from last year's harvest. However, projected carryin stocks of 4.4 billion bushels will help to cushion production shortfalls and total corn supplies in 1988/89 are projected to be 9.6 billion bushels, 133 percent of use. Corn prices at the farm are expected to average between $2.45 and $2.85 per bushel for the 1988/89 marketing year compared with the $1.90-$2.00 per bushel average expected during the 1987/88 marketing year.

Production of other feed grains is also projected to decline this year. The grain sorghum crop is generally rated fair-to-good. Over half of the U.S. barley crop and a third of the oats crop are typically produced in the Northern Plains states where the drought is most severe. Relatively large carryin stocks of grain sorghum and barley will help offset production shortfalls but oat carryin stocks are low. Oat imports are likely to increase to meet strong domestic demand.

The 1988 soybean crop is generally rated in fair-to-poor condition. In 13 of the 19 major producing states, anywhere from 25 percent to more than 60 percent of the crop is rated poor or worse. A year ago, no major producing state had more than 15 percent of the crop rated poor or worse. Soybean production this fall is projected to be 1.65 billion bushels, 13 percent below last year. With carryin stocks of 290 million bushels, 1988/89 soybean supplies will be tight, about 108 percent of use. Although supplies will be adequate to meet needs, higher prices will curtail demand and 1988/89 ending stocks will be low. Farm prices for the 1988/89 marketing year are expected to average between $6.75 and $9.25 per bushel compared to the $6.20 per bushel average expected for the 1987/88 marketing year.

The cotton crop is rated mostly fair-to-good compared with mostly good-to-excellent last year. Cotton production will be nearly 14 million bales, down 7 percent from last year, but larger than total use. With large carryin stocks and an expected decline in use, cotton supplies will be more than sufficient. Cotton prices have declined modestly in recent weeks to about 57 cents per pound compared with an expected average of 64 cents for the 1987/88 marketing year.

Fruits and vegetables and many other crops will be largely unaffected even though production may be down in some areas such as the Lake States. These crops are produced over wide areas in the United States and are often irrigated. The sugar beet crop is expected to be down modestly while supplies of sweet corn, green beans, carrots, beets, and tart cherries will also be smaller.

Crop production will increase next year because of higher farm prices this year if moisture conditions are favorable. More than 78 million acres of U.S. farm land have been held out of production this year by Federal programs. About two-thirds of this acreage can be used in 1989 to increase U.S. food and fiber supplies. Corn and wheat acreage idled this year, under normal conditions, can produce 30 percent of U.S. domestic use and exports.

Farm Income. Cash receipts from the sale of farm products in 1988 will likely be larger than last year. Farmers will partly offset reduced production by selling stored crops. Higher crop prices will more than offset lower marketings causing crop cash receipts to rise. However, livestock receipts may be down because of some distress sales, lighter weights, and lower prices. While cash sales will be larger this year, there will be a different distribution of income because of the drought. Crop farmers outside the drought areas will reap larger incomes from higher prices. In contrast, farmers in drought areas not only will have smaller crops to sell but they will also receive smaller government deficiency payments because of rising farm prices. Drought-affected farmers with Federal crop insurance will have smaller losses; about a fifth of major crop acreage is covered by Federal crop insurance. Livestock, dairy, and poultry producers will also be affected by the drought. Higher feed and forage prices will cut profits and increase the culling of livestock herds, leading to lower meat prices in the short-term but higher prices over the longer term.

Agricultural Trade. Reduced 1988/89 crop supplies and higher prices are likely to reduce the volume of U.S. farm exports and to increase unit export values. The United States has assured its customers that it will not impose any restrictions on exports of farm products because of lower supplies. Exports of U.S. grains in 1988/89 are projected to fall by 10 percent from 1987/88, from 98 million tons to 87 million tons. While smaller U.S. agricultural export volumes will open short-term opportunities for other food-exporting countries, the longer term competitiveness of the United States will not be affected.

The need for long-term global farm policy reform is not lessened by drought-induced higher prices and lower commodity stocks. In fact, the international market effects of production shortfalls are magnified because of policies that insulate producers and consumers from market forces. The short-term effects of the drought are higher prices that reduce pressures on national budgets, but continued high levels of producer support around the world and a return to normal rainfall will again raise the costs of government subsidies. Weather is not a substitute for policy reform. Therefore, the United States will continue to push for the elimination of trade-distorting subsidies in the Uruguay Round.

Food Prices. The drought is expected to add about 1 percentage point to food prices in 1988. Crop supplies will be more than adequate to meet domestic needs and exports. Total red meat and poultry production will likely be up 3 percent from 1987 and an all-time record. High feed prices and lack of forage have forced some producers to sell breeding stock, adding to current meat supplies. Reduced breeding stock will lower future meat supplies and raise meat prices. Food prices in 1989 may be up an additional 2 percentage points because of this year's drought.

Rural Communities. As of late June, 782 counties of the near 2,000 drought-affected counties were experiencing extreme drought. Of these 782 counties, nearly one-fourth have a major city or are adjacent to a major city. Most residents of these counties are not in danger of financial or economic dislocation. In agricultural-dependent counties affected by the drought, increased financial stress of farmers and reduced production could bring hardship for those who depend on the agricultural complex for employment. Nearly 20 percent of the total employment in drought counties is related to agriculture, either in production, farm input industries, or farm processing and marketing industries. Rural communities likely to be hardest hit are in the farming-dependent counties in the North Central and Mountain regions. The firms involved in the transportation and export of grains and soybeans and the food processing complex are most likely to be affected.

Forestry. Prolonged drought conditions have severely affected the Nation's forests. Almost all public lands are experiencing some problems related to the present drought conditions. The potential for major wildfire activity is greater now than at this time last year because the fire season has advanced by 4 to 6 weeks. This is the 4th consecutive year of drought in parts of the country that are heavily forested. Wildfire conditions in the Pacific Northwest and California are expected to be especially acute. Over 56,000 wildfires have occurred this year compared to 37,000 at this time last year. While fewer acres have burned so far this year, this could change quickly given current acute conditions on the Nation's forests.

The biggest difference between this year and last year is that fire conditions are critical in both the eastern and western States at the same time. This limits flexibility to move fire fighting forces from one part of the country to another in response to a wildfire emergency. However, as a result of the past 3 fire seasons and intensive training efforts, more trained and experienced fire fighters are available at the Federal, State, and local levels.

Extreme fire behavior is noted in many wildfires, requiring more machinery and personnel to suppress. Continued fire activity is expected as wind, lightning, and drought conditions persist. Some shortages of local and national fire suppression personnel and equipment are anticipated.

Widespread tree seedling mortality is occurring in first year plantations and in plantations which have been planted within the last 10 years. Replanting these areas will be necessary. Drought stressed vegetation is also more susceptible to attack by insects, causing further losses.

Over the longer term, the amount of timber harvested may be reduced for the next one or two decades to compensate for tree mortality and reduced growth. Some impacts of the drought will not be known for several months since weakened timber and forage species are more susceptible to death or disease. Some forests may take several years of normal precipitation to recover.

Transportation

Barge. The primary inland waterways have been greatly impaired by the drought. Record low water levels for June have been set for the Mississippi River downstream from Cairo, Illinois, and Ohio River flows are also low. Since early June navigation has been impeded by low water on several river systems. Recently the Apalachicola, Chattahoochee, and Flint Rivers system was closed when navigation depths dropped below six feet. The authorized depth is 9 feet. The Missouri is narrower and shallower than normal at several points. The most visible and most severe impediments to navigation, however, have occurred on the Mississippi and Ohio Rivers. The Ohio from its confluence with the Mississippi upstream about 20 miles to Lock and Dam 53 has had significant shoaling problems, closing navigation for several days at a time. The Mississippi River has been closed for short periods at a number of locations between Cairo, Illinois and Baton Rouge, Louisiana. Restrictions on draft and the number of barges per tow have been established to minimize the number of groundings which are occurring daily, often resulting in closure of the river. Short closures on main rivers create significant delays for the towing industries. A closure that lasts several days can delay about 100 tows involving as many as 2,000 barges. The cost per tow delay can be $5,000 to $10,000 per day. To alleviate this problem, as many as 12 dredges have been operating on the Mississippi, Ohio, and White Rivers. The Army Corps of Engineers is trying to minimize delays through intensive coordination efforts with the Coast Guard and the towing industry to identify and remove shoals before they close a river.

Barge rates for bulk commodities have more than doubled since the drought began. Since the lower Mississippi River ports carry nearly 40 percent of U.S. petroleum products moved by water, 20 percent of all transported U.S. coal and nearly 60 percent of U.S. grain headed for export markets, the impact on other sectors could be significant.

Delays and stoppages are expected to affect individual segments of the inland waterways system differently. Rivers and river segments with locking systems, such as the Illinois, Ohio and Upper Mississippi Rivers, are likely to be less affected by reduced water conditions than open river segments such as the Lower Mississippi River. Grain carriers, especially those carrying corn, will likely be hurt the most from the drought due to the long distances over which the commodity is moved and the large tow sizes used. Carriers moving petroleum and aggregate and construction materials will be affected less.

Railroads. In the short term, some of the losses experienced by the inland barge industry will mean added business for the railroads. However, the ability of the railroads to absorb large amounts of new business is limited.

The rail fleet might load up to 10-15 percent more grain than it is now handling, depending upon the origins-destinations involved.

Most of the traffic diverted from the primary inland waterway system will move by rail. So far, some increases in railroad traffic appear to be related to diversion of freight from the river system, but the total rail volume has not significantly strained the rail system nor created serious car shortages.

The railroads are bringing back cars into service that had been out on loan or in the shops for repair and are working with shippers to make use of privately-owned covered hopper cars to handle the demand for service. The supply of grain cars in the drought areas appears to be tight but not seriously limiting for the immediate future. There are no reports of congestion at receiving points or piers which might cause delays and back-ups in deliveries. Most of the grain going to export through the Gulf is being directed to facilities such as Mobile, Pascagoula, and Gulf points with rail unloading capacity, rather than to New Orleans piers not equipped to handle rail deliveries.

Water

Irrigation. Going into 1988, reservoirs in drought-affected areas served by the Bureau of Reclamation were at relatively high levels because of good carryover storage. However, in the severe drought areas of the Pacific Northwest, reservoirs will likely be near empty at the end of the irrigation season. Above normal winter and spring precipitation will be needed to refill reservoirs. In water-short areas, most irrigation districts reduced acreage planted to that which could be supported by the supply forecast at the beginning of 1988. With the exception of water users within the Friant Division of the Federal Central Valley Project, irrigators in California are receiving an essentially full supply through both State and Federal water projects, even though reservoir storage is below normal. Many irrigation districts, even those in which planted acreage was reduced to accommodate restricted water supplies, expect higher income than in 1987 due to drought-related higher crop prices. Some crop production losses are, however, expected in the Plains states.

Potable Water. Problems of water quality and supply problems have emerged in several areas throughout the Nation. In Idaho, several water districts and cities are experiencing severe water shortages and are using water rationing programs. Some localities in the West and Northern Plains have imposed water conservation and use restrictions. The Corps of Engineers indicates that potable water supply problems have not been reported so far at its reservoir projects. However, declining water quality is a growing problem.

A saltwater wedge from the Gulf of Mexico is migrating up the Mississippi and threatening municipal and industrial water supplies. An underwater sill is being constructed to stop the migration which has threatened New Orleans' water supply. Groundwater levels in Ohio are the lowest on record and statewide problems are expected. Conservation plans are being implemented.

Lake levels are being regulated to meet water supply and quality needs of Paducah, Kentucky. Minneapolis/St. Paul, Minnesota and Atlanta, Georgia are also anticipating water supply problems.

The TVA reports continuing stress on water resources in their region following the driest June in history. Reservoirs are far below normal summer levels for the fourth consecutive year due to the extended drought in the Southeast. Currently, demands for potable water are being met, although some communities have or are planning restrictions on water use. Areas dependent on wells are running short of water due to aquifer depletion. Water quality is deteriorating rapidly as water temperatures rise and dissolved oxygen levels fall. Some fish kills have been observed. Pollution problems have increased in some streams because of a reduction in flows needed for dilution and introduction of dissolved oxygen.

Extended periods of normal precipitation will be required to recharge reservoirs or groundwater supplies in drought-stricken areas. Several communitities and states are in the process of preparing drought action plans to address water management problems. A comprehensive survey of the municipal and industrial water supply situation has not been made, limiting a complete assessment.

Wildlife and Recreation

Wildlife is beginning to feel the effects of the drought. Low water levels have created problems with spawning of salmon in the Southern Oregon area as fish are forced to remain in larger rivers where spawning is less successful. Low rainfall has caused a decrease in the quality and quantity of waterfowl habitat. Lakes, ponds, and other wetlands have become increasingly stagnant or have dried up completely.

Most game birds depend on grass seeds for food, but in many areas vegetation has dried up without going to seed. Range grasses, which are also a source of food on western rangelands, have not only grown less than normal, but their nutritional value has been decreased substantially.

Wetland breeding habitats for many birds and small animals have been greatly reduced. Breeding habitat of deer, antelope, and other big game are also being reduced with the results to be seen in succeeding years. Hunting limits for some migratory species are likely to be reduced by the Fish and Wildlife Service.

Severe drought conditions have resulted in low-water hazards at many public and private recreation facilities. Approximately 10 percent of Corps of Engineers water resource projects are closed to recreation, mostly in the Southeast. Reservoirs in the Ohio and Missouri River basins are also affected. Similar conditions are expected at Bureau of Reclamation reservoirs.

Energy

Electric Power Generation. Hydroelectric power facilities operated by the Army Corps of Engineers in its Missouri River, North Pacific, Ohio River, and South Atlantic divisions are operating below normal because of the drought. Some Power Marketing Administrations (PMAs) have purchased additional power from other suppliers at a higher cost to meet contractual obligations due to the drought. Total outlays for purchased power are expected to reach $42 million in 1988 and an additional $72 million in 1989 if the drought persists. Revenues from power sales are falling below normal as generated power falls. Year-to-date estimates show U.S. hydroelectric generation down by almost 8 percent from 1987. Drought-related cost increases and revenue shortfalls will increase utility rates somewhat, but not until 1990 due to scheduled rate changes.

TVA hydroelectric power generation continues to be severely curtailed because of the drought. Generation is running at 53 percent of normal. The loss of hydroelectric production is expected to cost the TVA power system at least $150 million by the end of the current fiscal year. The cost of replacement power was $117 million through June.

Low river and lake levels have forced a small number of plants operated by public utilities to shut down due to inadequate cooling water volume and higher than allowable discharge temperatures. However, local effects have been minor. Some plants have experienced problems in receiving coal shipments via barge. However, smaller coal deliveries are mitigated thus far by the 60 to 90-day coal reserves maintained by most plants. Coal supplies could become a problem this winter when river levels normally decline.

Electric power generation at two fossil fuel plants are being affected by the low water levels on the lower Mississippi. A cofferdam and portable pumps are supplying supplemental water to the New Madrid Power Plant (New Madrid, Missouri). Measures have been taken at the Allen Steam Plant at Memphis, Tennessee to aid water intake and permit delivery of coal.

Petroleum. The saltwater wedge which is migrating up the Mississippi River also threatens the continued operation of three refineries located on the Mississippi River south of New Orleans (combined capacity is approximately 430 million barrels per day). These refineries currently are barging in fresh water for boiler and cooling purposes to maintain operations. In addition, barge delays have doubled transportation costs for petroleum products (especially asphalt, lube oils, and residual oils) which are shipped by barge.

Coal. Coal barge deliveries on the Mississippi and Ohio Rivers continue to be 10-15 percent below normal volumes. Some concern continues for electric utilities in Wisconsin that stockpile coal now for use during the winter months when the upper Mississippi is frozen.

Aggregate Economic Effects

The impact of the drought will be more severe in particular sectors and regions than for the overall economy. The crop losses and other impacts are likely to reduce overall farm production in 1988 by $5 to $10 billion in real terms. Inventory reductions will keep sales from declining by less than production declines. Higher prices will increase cash receipts in nondrought areas but will not offset crop losses in the drought-affected areas. Farm exports will rise in value terms in both 1988 and 1989 due to higher crop prices. Aggregate economic losses to the forest industry are difficult to assess at this time.

There will also be costs to other sectors. Economic costs due to less efficient barge transportation may reach $1 billion but will be somewhat mitigated by substitution among alternative transportation modes and routes. Electrical generation costs are a problem in local areas such as the Tennessee Valley and the Pacific Northwest. Information is not available to assess these local impacts on a national basis, but they are small relative to economy-wide energy supply and use. So far, shortages of water for residential and industrial uses are localized. Impacts on economic output have not yet been felt except in a few specific instances.

The expected increase in food prices due to the drought for 1988 and 1989 will raise the Consumer Price Index (CPI) a small amount. Food purchases comprise about 16 percent of the average consumer's budget, suggesting a rise of about an additional 0.2 percentage points this year due to the drought. This leaves the projected CPI increase for 1988 in the range of 4-5 percent. The drought would add about 0.3 percentage points to the CPI in 1988.

The impact of the drought on crop production and other sectors' output is projected to cause a drop in Gross National Product (GNP) of about 0.2 percent. Lowered inventories, higher crop prices, and other adjustments cause indirect effects that spread throughout the economy. Allowing for these indirect effects, however, does not alter the basic result that the severe drought now being forecast should not cause a significant reduction in the projections for real GNP growth in 1988 and 1989.

III. FEDERAL RESPONSE TO ALLEVIATE DROUGHT EFFECTS

Federal agencies are continuing to respond to the drought. The Department of Agriculture is assisting livestock producers and the Secretary of Agriculture has been working closely with the bipartisan Congressional Drought Relief Task Force to consider additional financial assistance. Other Federal agencies are responding to help alleviate the drought's effects.

Department of Agriculture

Assistance to livestock producers has been one of the highest priorities. Deteriorating spring hay crops, rising feed costs, and drying stock ponds have forced some livestock producers to liquidate herds. The Department of Agriculture has authorized several feed assistance programs to help livestock producers and has made available $50 million to buy beef and pork for domestic feeding programs and has created a $40 million line of GSM-102 credit for Mexico to purchase frozen or chilled meat.

Emergency Haying and Grazing. The USDA has moved quickly to add to forage and feed supplies for livestock. Beginning May 31, the Commodity Credit Corporation (CCC) authorized the haying and grazing during principal growing months of cover crops on land withdrawn from production under annual crop production adjustment programs (Emergency Haying and Grazing). By July 14, 2,007 drought-affected counties in 38 states had been approved for emergency haying and grazing. These same counties are also permitted to harvest hay for 30 days on cropland idled under the long-term Conservation Reserve Program. This is highly erodible cropland retired from production under 10-year contracts with the Federal Government. Much of this land has established grasses, offering an important source of additional forage. Precautions are being taken to protect against erosion. Additionally, haying of Water Bank Program lands has been approved in 181 counties in 11 states.

The USDA and state agricultural officials have established HayNet--a national hay information network--to help locate available hay and identify forage needs in drought areas.

Emergency Feed Programs. The Emergency Feed Program (EFP) and the Emergency Feed Assistance Program (EFAP) are providing access to feed. Under EFP, CCC shares the cost of feed with livestock producers who have drought-induced production losses. Under EFAP, CCC-owned feed grain is provided at reduced prices to eligible livestock producers. As of July 14, the EFP and EFAP had been approved for 763 counties in 25 states.

Financial Assistance Programs. Priorities are shifting to providing income support for farmers. Federal crop insurance is available for most crops in almost all counties. About 45 million acres--21 percent of potential acres--were insured in 1987 and a similar percentage was expected in 1988. Crop insurance field personnel are being brought up to full strength quickly to effectively handle the expected unusually large number of claims.

The 0/92 program provision also provides financial assistance for producers participating in the 1988 wheat and feed grain programs. In 82 counties in 16 states where drought has prevented plantings, farmers will be eligible to receive 92 percent of their projected deficiency payments on acreage which they were prevented from planting.

These financial measures will not help all drought-affected farmers. Uninsured participants in 1988-crop programs who did plant and have greatly reduced yields will suffer income losses. If crop prices remain high over the next 12 months, under current law producers must repay some of the $4.3 billion in 1988 program payments paid in advance this spring. Other producers in drought areas face income losses if they did not participate in crop programs or if they produce nonprogram crops such as soybeans, or fruits and vegetables.

Authority also exists to offer low-interest disaster loans to farmers through the Farmers Home Administration for emergencies declared by the Secretary of Agriculture or major disasters declared by the President. To date, no Secretarial or Presidential disaster declaration has been made. To be eligible for disaster loans applicants must have purchased Federal crop insurance where available.

Department of the Interior

In March drought coordination teams were created within each of the Bureau of Reclamation's five regions. These teams have established drought awareness and response programs which have served as information clearinghouses for water banking, water sales, transfers of water, storage, and equipment sales and leasing. In addition, a network has been established within the agency to coordinate initiatives to mitigate the effect of drought. An inventory of pipe, transformers, and pumps that could be used to meet critical water conservation needs has been completed.

Water transfers have been encouraged and assistance for such transfers has been provided under the Warren Act and other applicable laws. The Warren Act of 1911 allows the Bureau of Reclamation to use surplus canal and reservoir capacity to assist non-Reclamation project irrigators in providing water to irrigate up to 160 acres of land. It does not give Reclamation authority to provide water for municipal and industrial or miscellaneous (fish and wildlife protection, for example) uses. Inter-district water sales within the Yakima Project in Washington are being allowed. In addition, irrigators in the Boise Project in Idaho will be allowed to move the use of water from one field to another, enabling them to provide full irrigation on one field while leaving another field dry.

At the request of the Governor of North Dakota and in concert with the State, the Fish and Wildlife Service has opened up many National Wildlife Refuges and Waterfowl Production Areas for emergency haying. USDA and Interior have agreed to allow emergency haying on certain Water Bank Program lands. Approval was effective July 1, 1988 in certain counties and will be effective within 15 days of that date in others. Haying will be allowed for a 30-day period from the date of the approval. Grazing of this acreage is not authorized. Ten percent of the land nearest the wetland will not be hayed and haying will begin on the land farthest from the wetland and progress inward. Participants haying on these lands will have their next per acre rental payment on these lands reduced by 25 percent for each acre hayed.

Due to widespread drought conditions and expected poor production from blue-winged teal, the Fish and Wildlife Serve has eliminated all of the special early hunting seasons for that species, and reductions in the fall waterfowl seasons may be necessary.

The Bureau of Reclamation also is working closely with the Fish and Wildlife Service and the California Department of Fish and Game to explore ways to overcome warm stream flows that would endanger successful fall spawning of Chinook salmon and to provide water supplies to waterfowl refuge areas in the San Joaquin Valley.

The Bureau of Land Management is providing assistance to those with grazing permits in drought areas. Federal and State agencies are coordinating use of available forage supplies in Idaho. Also, ungrazed areas are being opened to relieve pressure on grazed areas.

The Bureau of Land Management is working with ranchers to adjust current grazing practices, to investigate grazing alternatives involving underutilized or ungrazed areas, and to assist with livestock water distribution where possible. The Bureau of Indian Affairs and the Fish and Wildlife Service are involved in similar activities to support grazing on the lands they manage.

The Boise Interagency Fire Center, a national fire support center for Federal and State agencies, is ready to provide planning, supplies, communications, and personnel support during the potentially severe 1988 fire season. Fire Center warehouses can provide support for 8,000 firefighters at any given time in addition to fire intelligence. During the 1987 fireseason, the Fire Center provided support to 1,600 wildfires and moved 32,000 personnel.

Army Corps of Engineers

Dredging. The Army Corps of Engineers has undertaken extensive dredging operations to maintain the principal rivers of the inland waterway system that are experiencing record low levels. A total of 12 dredges have been working in the most severely shoaled areas of these rivers. Other available dredges have been identified in case the situation deteriorates and additional dredging is needed. The Corps of Engineers, Coast Guard, and the barge operators are working closely to coordinate traffic demands, monitor channel conditions, and minimize delays.

While the Mississippi main stem is experiencing numerous closures, the Tennessee-Tombigbee Waterway has provided an alternative route from Cairo, Illinois to the Gulf for some shippers. The traffic on the Tenn-Tom has gradually increased as shippers seek alternatives to the delays on the Mississippi. While the Tenn-Tom is an alternative route of a distance comparable to that for the Mississippi, the waterway is less efficient in the tow size it can handle.

Saltwater Intrusion. Construction of an underwater sill by the New Orleans District to serve as a barrier to retard saltwater intrusion up the Mississippi River towards New Orleans is nearing completion. The barrier is reducing salinity upstream so that drinking water supplies for New Orleans will be protected.

Water Quality. There is quality degradation in some areas as a result of reduced inflows to Corps of Engineer reservoirs and low flows in the streams. The Corps is managing reservoirs to minimize water quality degradation, consistent with project authorizations and other project purposes.

Water Supply. In the Tennessee and Cumberland River basins the Corps of Engineers is working closely with the Tennessee Valley Authority to regulate lake levels and releases from Barkley and Kentucky Lakes to meet water supply and water quality needs for the City of Paducah, Kentucky. The Corps of Engineers together with the State of Minnesota is studying a plan for the Corps to make releases from upper Mississippi reservoirs to augment flows in the vicinity of Minneapolis and St. Paul water supply intakes.

Extreme low flows in the Chattahoochee River Basin have created a situation where the discharge from the Corps of Engineers' Lake Sidney Lanier accounts for the total flow in the river past the water supply intakes for the City of Atlanta.

Lake Michigan Diversion. There have been a number of recent requests that the Army Corps of Engineers direct a temporary diversion of water through the Lake Michigan Diversion at Chicago to increase depths at the most shallow portions of the Mississippi River and thereby improve navigation. This is a complex issue with economic, judicial, legislative and international implications. Limitations imposed by Supreme Court decisions and recent Congressional enactments must be carefully evaluated prior to making a final decision. Equally important is an understanding of the dynamics of the Mississippi River and the relationship between flows and navigibility. The Army Corps of Engineers is focusing on these issues in its decision process.

Department of Transportation

The Coast Guard has provided increased assistance for navigation such as buoy markers because of low river levels. Cutters scheduled for drydock have continued to work on the waterways due to the drought. Additional personnel and equipment have been called upon to assist in the delivery of navigational equipment and to disseminate information on channel conditions.

Tennessee Valley Authority

The TVA is managing its reservoir system to assure water supply to communities drawing from its reservoirs, to protect water quality as much as possible in the mainstream reservoirs, to provide a navigable waterway from Knoxville, Tennessee, to Paducah, Kentucky, and to provide hydroelectric generation during peak hours of the day.

The goal is a steady 12,000 cubic feet per second (cfs) discharge from Kentucky Dam to help protect water quality in the system, in Kentucky Lake, and downstream of the dam, and to support navigation on the lower Ohio-Mississippi River system. Because of heavy evaporation losses, TVA is moving 18,000 cfs past Chattanooga. Tributary reservoirs are in the drawdown phase of their cycle and this will continue through the summer and fall.

In addition, TVA is participating with other Federal and State agencies on a Tennessee Valley Regional Drought Task Force; on State task forces in Tennessee, Alabama, Kentucky, and with a Corps of Engineers task force in Atlanta. The agency is providing technical support to help water utilities deal with water quality problems. And the agency is conducting extensive drought monitoring and providing information to State and Federal agencies in the region.

Federal Emergency Management Agency

FEMA has not identified any situation where a Presidential major disaster declaration would be needed to provide assistance. FEMA recently addressed two requests for fire suppression assistance from South Dakota. Based on recommendations from the U.S. Forest Service, both were determined not to threaten such destruction as would constitute a major disaster, and were denied. Local, State, and other Federal agency responses are adequate so far in South Dakota and other States with fire problems.

FEMA has agreed to participate in a preliminary assessment of unemployment in North Dakota. The Department of Labor (DOL), which administers the disaster unemployment assistance (DUA) program through States (with 100 percent funding from the President's disaster fund), will also participate. FEMA and DOL are now outlining issues for this assessment, including the timing and extent that farmers, persons in water-related businesses, migrant workers, and others are experiencing drought-caused unemployment; and how long unemployment should be attributed directly to the drought.

IV. ADDITIONAL MEASURES

Measures to address the effects of the drought are being considered by both houses of Congress and the Administration. Congressional and executive branch proposals are undergoing interagency evaluation in view of their ability to provide effective relief to those most affected by the drought and ongoing efforts to reduce the Federal deficit.

Department of Agriculture

Legislation is needed to aid farmers who will suffer losses due to the drought. The administration has set forth five goals for this legislation:

- o Relief should go to those who need it most in order to make best use of the available funds.

- o Farmers who puchased Federal crop insurance, a sound business decision, should not be penalized relative to farmers who failed to act with such prudence.

- o The legislation should not have undesirable side effects, such as encouraging farmers to incur losses in order to receive assistance.

- o Drought relief has to be considered in the context of efforts to reduce the Federal deficit, according to the November 1987 Budget Agreement reached with Congress.

- o This temporary emergency should not serve as an excuse to rewrite existing farm policy.

The bipartisan Congressional Drought Relief Task Force has developed comprehensive disaster assistance legislation. This legislation was introduced in both the House of Representatives and the Senate on July 12. The proposal provides payments to producers with production losses greater than 35 percent of normal production. This assistance would be provided to all drought-affected producers for both program and nonprogram crops. Existing emergency feed programs would be revised and assistance would be limited to $50,000 per producer. In addition, there would be an overall limit on all disaster payments of $100,000 per person. Disaster payments would not be reduced because of Federal crop insurance indemnity payments.

This bill would provide effective disaster assistance if it advances unemcumbered with provisions unrelated to the drought and meets the goals delineated above.

Department of the Interior

Legislation on other aspects related to the drought is also moving through Congress. On June 22, 1988, the House Interior and Insular Affairs Committee marked up Title IV of S. 795. Title IV of S. 795 would authorize or direct the Secretary of the Interior to engage in various activities to mitigate the effects of the drought, including construction of facilities, redistribution of water between willing buyers and sellers within the constraints of state water law, defer water payments when contractors do not take delivery of water in order to make it available for other users, make surplus water available on a temporary basis, defer the 1988 and 1989 payments owed by irrigators, reprogram funds, and make emergency loans. Title IV would also amend the Warren Act to authorize the Secretary of the interior to make available surplus capacity in canals and storage facilities for use by municipal, industrial, and domestic customers, and for fish and wildlife protection. Current law provides such authority only for irrigation purposes, and then only for farms up to 160 acres in size.

The Department of the Interior is already taking many steps to deal with the drought. In addition, many provisions of Title IV are duplicative of the Department's existing efforts and authorities and are, therefore, unnecessary. Furthermore, other provisions of Title IV were not effective in dealing with the situation faced in the 1976-77 drought. For example, the construction provision of section 401 will not be effective for the following reasons:

(1) The construction will almost certainly not be completed in time to help with the current drought; and

(2) The water users may use the authority to build features designed to satisfy future needs not necessarily related to drought relief.

<u>Army Corps of Engineers</u>

<u>Emergency Water Assistance.</u> The Assistant Secretary of the Army (Civil Works), (ASA(CW)), is authorized under PL 84-99, as amended, to transport emergency water supplies for human and livestock consumption when an area has an inadequate water supply and is likely to cause a substantial threat to the public health and welfare of the inhabitants of the area.

The process to initiate assistance under this program should begin with a written request from a rancher, farmer, or political subdivision through the Governor or Governor's representative to the appropriate Corps District Engineer. If the area has not been declared drought distressed by ASA(CW), an analysis is done of the drought situation and a recommendation is forwarded to the ASA(CW) for decision on whether to make a declaration. There are no specific analytical criteria due to the wide variance of situations which could impact the public health and welfare from region to region. For drought declared areas, the District Engineer evaluates requests for assistance and forwards recommendations to the Army Corps of Engineers. As of July 11, 1988, requests for assistance have been received by Corps districts from the State of Mississippi; Scobey, Montana; State of Arizona; State of Louisiana; and State of Iowa.

Emergency Water Planning, EO 11490. The Corps has the responsibility to plan for management and control of water resources in national security emergencies or domestic emergencies which affect national security. Emergency water planning includes coordination of water resources and development of plans to assure that public water supply utilities and critical defense production facilities are provided water from public water supply projects under the jurisdiction of the Assistant Secretary of the Army. Plans also address emergency operations of waterways and harbors and provision of potable water.

Federal Emergency Management Agency

FEMA operations are guided by provisions contained in the Disaster Relief Act. Assistance under the Act is specifically intended to supplement the capabilities of State, local, and other Federal agencies' to address drought problems. With few exceptions, the Act's major programs address non-agricultural damage and physical losses to homes, businesses, and government and public facilities. The exceptions are fire suppression grants, disaster unemployment assistance (DUA), and emergency measures to protect public health and safety. If the drought worsens to the severity and magnitude that effective response is beyond local, State, other Federal agency, and voluntary response capabilities, the President may address Governors' requests for these measures.

Considerable authority and capability already exists to address current drought effects as indicated elsewhere in this report.

V. PROGNOSIS

The drought has intensified and spread from the Northwest through the northern Great Plains and into the Southeast. Below normal precipitation and above normal temperatures have produced severe crop stress, especially in the eastern Corn Belt. Based on conditions on July 1, this year's grain crop will be reduced 24 percent from 1987 and soybean production is projected to be down 13 percent. These losses are large and irreversible at this point. However, large grain carryin stocks will moderate potentially adverse effects on domestic and foreign consumers. Additional production capacity from large land reserves can be drawn upon next year. Forage and range feed conditions are the worst on record, causing losses for livestock and dairy producers. The immediate problem is not one of shortages, but rather in responding in a compassionate way to the losses faced by farmers.

Measures have been implemented by Federal agencies and supplemented by State efforts to alleviate the effects of the drought on reduced forage supplies. Additional measures to provide financial relief to farmers with crop and livestock losses have been proposed by the Bipartisan Drought Relief Task Force. The compensation provided by these measures will help offset the losses experienced by drought-stricken farmers.

Impacts of the drought on other sectors of the economy in many instances is not yet known. Disruptions in barge transportation will continue to occur on the Mississippi and Ohio rivers resulting in losses to barge operators. Other modes of transportation are available, however, at higher costs. The Nation's forests are threatened by losses due to wildfire, pests, reduced growth, and seedling mortality. Hydroelectric facilities are operating below capacity and other power generation facilities are threatened by inadequate water supplies. Municipal water supplies and water-based recreation and wildlife are also impacted. If the drought worsens, conditions are likely to be severe in both the short and long term because of the length of time required for streamflows, reservoirs, and groundwater supplies to recover once normal precipitation resumes. Increased diligence in management and coordination of resources in these areas is needed.

THE UNITED STATES TRADE REPRESENTATIVE
Executive Office of the President
Washington, D.C. 20506

August 5, 1988

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: CLAYTON YEUTTER Clayton Yeutter by M/h Smith, acting

SUBJECT: USITC Investigation on U.S.-Japan FTA

At the request of the Senate Finance Committee, the USITC is conducting a survey of views on the pros and cons of entering into negotiations with Japan to explore the possibility of establishing a U.S.-Japan free trade arrangement. A number of Administration officials have been approached by the USITC for their views on this topic.

At my request, the question of the need for a common Administration position in reply to USITC inquiries was discussed at an informal meeting of the TPRG two weeks ago. The TPRG agencies--State, Commerce, Agriculture, Labor, Treasury, CEA, OMB and NSC--concurred and noted that the position taken in my draft reply to the USITC was acceptable.

I believe the EPC should adopt a common Administration position on this issue and instruct agencies to respond to any USITC inquiries along the lines contained in my letter.

Attachment

DRAFT

August __, 1988

Mr. Kenneth R. Mason
Secretary
United States International Trade Commission
701 E Street, N.W.
Washington, D.C. 20436

Dear Mr. Mason:

This responds to your letter dated June 15 in which you request our views on "the pros and cons of entering into negotiations with Japan to explore the possibility of establishing a U.S.-Japan free trade area agreement" (FTA), a request pursuant to the Commission's Notice of Investigation No. 332-255 responding to the letter to Chairman Liebeler dated June 15 from Senator Lloyd Bentsen, Chairman of the Senate Committee on Finance.

Let me state at the outset that this Administration has vigorously pursued the multilateral GATT trade negotiations in the Uruguay Round. It is our belief that this effort is essential to liberalize trade in goods and services, including agriculture, to improve intellectual property protection, and to strengthen disciplines over international investment measures. This commitment to the multilateral approach has been strong not only in this Administration but in previous administrations, which have placed high priority on the GATT rounds of trade negotiations.

In this context, we believe it would be inappropriate at this point to initiate negotiations with Japan on the possibility of establishing an FTA between our two countries. We are now in the midst of moving the Uruguay Round negotiations forward, and the initiation of any major bilateral FTA undertakings at this time, before we have the opportunity to see the results of the current GATT round, would be premature. In the meantime, of course, we have pursued bilateral negotiations with Japan on certain sector-specific issues, such as beef and citrus, with considerable success.

We remain receptive to bilateral initiatives such as the U.S.-Canada FTA, which we believe to be fully consistent with the GATT. And it may be appropriate for future administrations to

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consider similar bilateral arrangements with other countries. At this point in our GATT multilateral efforts, however, initiating FTA discussions between the world's largest and second largest market economies--i.e., the United States and Japan--would be premature.

Moreover, there are important differences between the U.S.-Japan and the U.S.-Canada trade relationship. Thus it is not at all obvious that the U.S.-Canada FTA would provide the appropriate model for structuring our trade relationship with Japan.

We hope this responds to your question regarding the advisability of entering into negotiations with Japan to explore the possibility of establishing a U.S.-Japan FTA. We look forward to seeing the results of your study in September.

Sincerely,

Clayton Yeutter